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ABSTRACT

Tuition futures programs and alternative plans are considered that might be enacted in New York State. Tuition futures is a college finance technique that involves a guarantee of stable tuition rates in return for payment years in advance. After describing tuition increases nationwide and in New York State, information is provided on prepayment or guarantee plans, tuition stabilization plans, tuition gift certificates, and tuition futures plans. Some elements of a state tuition futures plan are described, including: the residency and age of beneficiaries; purchasers' residence and relationship to the beneficiary; types of participating colleges; and administration of the trust. Issues concerning viability that are inherent to the tuition futures idea are considered, along with some possible modes of state involvement and questions of effectiveness and fairness. Brief information on tuition futures laws and bills in the following six states is presented in an appendix: Michigan, Wyoming, Tennessee, Indiana, Florida, and Maine. Two federal proposals are also briefly described, and the text of a bill to create the Michigan education trust is given in full. A second appendix contains brief descriptions of proposals for saving incentive plans in Pennsylvania, New York, Illinois, Missouri, Georgia; H.R. 817, the Family Education Assistance Act of 1987, is also described. A list of 110 endnotes concludes the document. (SW)

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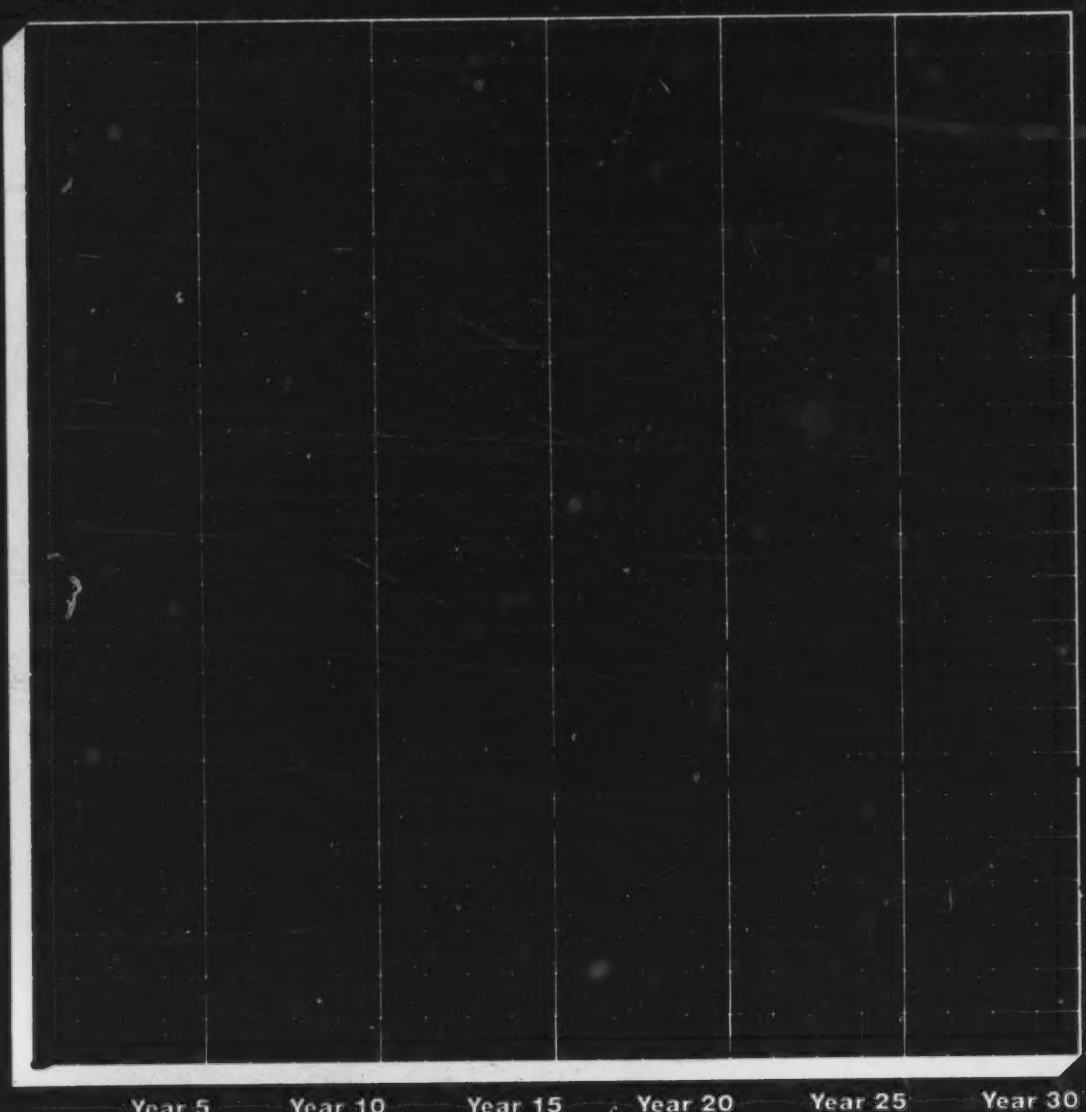

New York State
Senate Research Service
Task Force on Critical Problems
Albany, New York
November 1987

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TUITION FUTURES IN NEW YORK:
A Bearish Prospectus

A Report by the
New York State Senate Research Service
Task Force on Critical Problems

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November 1987

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EXECUTIVE SUMMARY

Accelerated Inflation and a Financial Gap

Recent inflation in college tuition fees has caused concern. Nationwide, tuition has risen during the 1980s at double the general inflation rate and faster than income. This is a significant speedup from the 1970s, and there is fear about the consequences:

- Students increasingly are emerging from college heavily in debt; their indebtedness is four times greater than a decade ago.
- The loan burden is an economic problem in itself, but the problem may be compounded by the effect it has on selections of college majors--students may avoid fields in which first jobs do not offer high salaries.
- The quality of instruction may be in jeopardy, as college administrators try to cut costs.
- There may be less aid available for the neediest students.

Recent federal changes add to the fear. The 1986 tax reform reduced the deductibility of interest paid on student loans and incentives for charitable contributions, through which independent colleges, especially, obtain revenues. Federal grants cover a declining percentage of college costs, and federal loan programs are becoming even more predominant.

New York State's support of higher education through appropriations for institutions and students has been pioneering and large. Its student aid constitutes more than one-fourth of the total amount of student aid given by all the states. Despite the State's relatively massive effort, however, the amount of assistance New York's collegians receive from the State is only about one-fourth of the amount they receive from the federal government. It's understandable, then, that the recent changes in federal policy and appropriations have buffeted colleges, students and families even more than could most changes the State might make.

At the public colleges, State assistance has escalated in reasonable proportion to cost increases, and tuition increases have not significantly exceeded increases in people's typical incomes. Neither of these conditions holds at the independent colleges: there, tuition is increasing faster. Independents' tuition fee revenues must cover a growing proportion of their operating expenses and assistance to students.

There appears, then, to be a gap developing between college costs and available resources. One way to partly close that gap is the use of family savings.

Tuition Futures

In response to the development of this gap, colleges have created several new means of tuition payment. Some delay payment; others accelerate it. Tuition futures is one of the advance payment techniques. The typical, individual institutional program of advance payment involves paying a lump sum, at the time of matriculation, to the college to cover all of four years' tuition. The college gets the money "up front" to invest or enhance its efficiency; families and students, paying tuition fully at a rate charged at the time of payment, avoid subsequent tuition increases.

The kind of advance payment program we will explore here differs from the individual institutional plans. We are interested in plans whereby:

- payment would buy a stable tuition not just at a single college, but at any of a group of colleges; and
- payment would occur more distantly prior to matriculation, when the prospective student is, for instance, in grade school.

Chapter 2 reviews the major contract points addressed in tuition futures proposals. They relate to eligible beneficiaries, purchasers, participating institutions, and administrative procedures.

The basic problem of designing a tuition futures plan is to distribute risk such that both sets of parties--institutions and investor-parents--will find it advantageous to contract with each other.

The Ideal Plan for Institutions--The primary objective of the institutions in a tuition futures plan is to enhance the enrollment base--or more generally, the revenue base--while not taking on too much financial risk. To do this, they wish to use investors' monies freely and over an extended period in order to deal with institutions' central risk--that earnings on the monies they collect

will fail to keep pace with increases in tuition fees. To improve the probability that their earnings on investors' payments will be adequate, institutions would include these features.

- The plan would limit withdrawal. If a beneficiary for any reason failed to register for college (at all or for less than four years), only the prorated principal would be returned to the investor; earnings would accrue entirely to the institution.
- The plan would limit portability. Investors would have to specify one college at which the tuition guarantee would be valid.
- The plan would limit transferability. Prohibiting parent-investors from using benefits for the brother or sister of the named beneficiary would increase the institutions' opportunity to obtain the withdrawal profit and would ensure that the investment earnings (based partly on the child's age) would have time to accrue sufficiently.
- The plan would avoid tuition discounts.
- The plan would require lump-sum payment.

Under the institutions' ideal plan, the investors would bear virtually all of that risk which is related to prediction of what a beneficiary will actually do when he or she reaches college age.

The Ideal Plan for Families--The primary objective of the families is to obtain peace of mind about the problem of paying rapidly escalating tuition fees, and their ideal plan would permit attainment of this goal without their giving up too much flexibility--the components of an ideal plan from a family's standpoint would require the institutions to bear the portion of risk based on the beneficiary's eventual decision. The plan would have these features.

- Withdrawal would result in no penalty.
- The guarantee would be portable.
- Transfer to a new beneficiary would be permitted.
- Tuition would be discounted.
- There would be installment payment options.

Finding a Balance

In moving from two ideal contracts to a working contract, then, there is a question: Can institutions and investors agree on a distribution of risk--a

balance--such that substantial numbers of both institutions and parents will be willing to contract with each other? The features of the plans do offer opportunities for bargaining--for different configurations of withdrawal, portability, transferability, discount and financing features.

But actual plan design is more complicated than simple bargaining between institutions and investors; there are problems of tuition variation among the institutions that form consortia to offer the plans, and there are problems of taxation.

Tuition Variation Within College Groups--The institutions are likely to have differing tuitions, and projections of tuition at each institution will commensurately differ. The amount which a tuition futures investor is required to pay, however, is based on a single projected tuition fee. Therefore, in a consortium of institutions with various tuition fees, an investor paying an amount in the middle of the range of tuition fees could well be conveying to the consortium an amount that will be:

- too low for higher-priced institutions to avoid loss if the beneficiary selects and is admitted by one of them; and
- too high for the investor to avoid an earnings loss if the beneficiary attends a lower-priced institution.

One approach to this problem would be to make the guarantee completely portable and to treat the matter as simply another risk: The consortium would project an average tuition fee and then specify an amount required from the investor. If the beneficiary attended a higher-priced institution, the investor would have won the bet and the institution would have lost; if the beneficiary attended a lower-priced institution, the result would be the opposite.

Another approach would be to make the guarantee completely unportable; it would be applicable to only one institution within the group, and the amount paid by the investor would be determined by the tuition level at the designated college.

One compromise approach would be for the consortium to establish a tier system of institutions based on tuition levels. Families could target their investments to a particular tier.

Fundamentally, the problem of inter-institutional agreement is this: How big a difference in tuition levels will a higher-priced institution tolerate? The bigger the difference, and the greater the number of institutions with lower

tuition, the greater is the fiscal jeopardy in which a higher-priced institution places itself. It does not seem unreasonable to expect that many college fiscal officers would oppose any kind of linkage of their costs with the revenues receivable at lower-priced institutions.

The Taxation Dilemma--Many think that federal taxation could undermine the marketability of tuition futures plans: If the IRS deems a plan to be a "savings" or "investment" plan, it would most likely be taxable. If the plan is a "prepayment" plan, it could be "considered a sale of services for future delivery at the time of the initial purchase [with] no gain at maturity and no tax upon surrender." (1)

Taxability and inflexibility each could render a plan unsalable, and the more flexible are a plan's provisions, the greater is the risk of taxation; the IRS would consider earned appreciation to be capital gain.

The offering of contracts in Michigan's plan is contingent on a ruling from the IRS. Most states considering plans await the Michigan verdict.

Enter the State?

Current proposals for tuition futures plans (other than plans for single institutions) would involve state governments. Authorization of public colleges to become involved in tuition futures plans might oblige the state, in order to protect the interests of taxpayers and nonparticipating students, to monitor the plan's projections and procedures. The proposals, however, call for the state to create a plan and in some way operate it. Why do proposers choose a "make it work" role for the state rather than a "let it happen" role? Underlying the proposals for state involvement may be some skepticism:

- skepticism that investor-families and colleges can arrive at an apportionment of risk that is agreeable to both; and
- skepticism that expensive colleges and inexpensive colleges can agree on the technical arrangements necessary for them to offer a tuition guarantee cooperatively.

Proposals for state tuition futures plans, then, may derive in part from an expectation that tuition futures plans won't work unless the state, by absorbing some of the risk, offers itself as a bridge between investors and institutions.

There are several abstract modes of possible state involvement, with risk for the state ranging from little or none to considerable. The state could:

- simply oversee operations, ensuring solvency;
- operate the plan essentially as a fiduciary;
- absorb some risk through annual appropriations or through coverage of shortfalls; and/or
- supplement the plan, providing loans to investors to reconcile the need of institutions to receive payments in lump sums with the need of many investors to pay in installments.

State involvement greatly complicates the tuition futures idea. All the design problems (discounts, lump-sum requirements, withdrawal, portability, transferability, inter-institutional arrangements, plus the matter of determining residency) remain pertinent. But there are, in addition, questions of policy effectiveness and fairness.

Effectiveness--The importance of the independent sector is a clear and even cultivated fact of higher education in New York State. This makes a tuition futures plan harder to design here than in Michigan. There are more colleges at which tuition is a major revenue source, and in an atmosphere of rising costs, administrators at those colleges must be generally wary of putting any limits (including a guarantee) on that revenue source. The amount of risk the State would have to absorb in order to make a plan with much portability work would be far greater than in Michigan, where the State controls the tuitions of the vast majority of students and institutions.

The State could avoid these problems by creating a tuition futures plan that excluded the independents. But this would seem to be an essentially faulty tactic in dealing with the problem of college costs: Excluding the independents would fail to attend to the instances in which tuition is the most significant burden. And treating tuition at public colleges would be attending to that part of public college costs which is the minor burden. Tuition and fees at the State University over the past five years have held at about one-fourth of all costs; it's room and board that is the major share--about three-fourths--of the costs.

At the independent colleges, however, tuition is the major and increasing burden: The percentage of college costs attributable to tuition rose from 56.1 in 1980-81 to 60.2 in 1986-87; the percentage constituted by room and board declined from 43.9 in 1980-81 to 39.8 in 1986-87.

Choice and Fairness--We have suggested that the simple feasibility and cost-effectiveness of the tuition futures idea in New York State is questionable. But there also are questions of consistency and fairness.

Questions of consistency pertain in a most direct way to some of higher education policy's central criteria--choice and access.

- Students' Choices--Would the practical effect of a tuition futures plan be to prevent many students from selecting colleges that would be best for their aptitudes? Beneficiaries approaching college age would know that selections contrary to their parents' predictions could be costly. Could such knowledge subtly press a student with strong inclinations toward the liberal arts into enrolling at a college that emphasizes engineering? Worse, could such knowledge actually work to form a student's inclinations?

- Institutions' Choices--Would there be similar pressure on college administrators? Rejecting an applicant who is a plan beneficiary, especially in a plan with provisions that leaned toward investors' needs, could mean that the college would have to return the investment. At a college with declining enrollments, that could mean foregoing entirely the amount of revenue which college budgeters had counted on for that enrollment slot. Would this situation--far from impossible at a time when the number of people of full-time student age is declining--cause administrators to implicitly alter their acceptance standards? Could it give plan beneficiaries a competitive advantage for acceptance over those not enrolled in plans (and especially over those who need financial aid)?

Such influence is contrary to a pro-choice policy, which is intended to increase the probability of a match between institutions' strengths and students' aptitudes.

The most apparent questions of fairness have to do with special subsidization of the college costs of plan participants. This subsidization would occur if projections were inaccurate.

- Would it be fair to non-participants if mistakes in plan projections required colleges to raise tuitions in order to make up incurred deficits? If this happened in an independent college consortium, the non-participating students would at least have the option of switching to public colleges or non-participating independent colleges. In an institutional group including the public colleges, however, this option would not be available. The most obvious design feature to avoid this would be to have future plan participants cover plan deficits by paying higher amounts for enrollment in the plan. But that would eventually reduce the plan's attractiveness to investors, and the number of plan participants could decline, perhaps to the point of negligibility in the colleges' budgets.

- Would it be fair to taxpayers, some of whose children would be students not enrolled in the plan, if the state had to "bail out" the plan, use the government's borrowing capacity to fund it, or increase institutional aid in order to compensate for plan-incurred deficits?

There is another question of fairness, however, which occurs even if a plan works as it's supposed to. Is it fair to investors if, by virtue of their participation in a plan--that is, by virtue of their saving--their children end up being ineligible for tuition aid they otherwise would have received?

The idea that need-based aid penalizes savers applies not only to tuition futures proposals, but to most uses of saving for college costs. Taken alone, then, it's not a compelling argument against tuition futures. A state tuition futures plan, however, would compound the unfairness--tuition futures is a form of saving which not only could disqualify students from aid, but would almost inescapably limit choice.

The Need for a Saving Incentive

"Higher education . . . is conspicuously alone in creating a need for savings for which there is an acknowledged public value yet no public inducements for private saving." (2) This statement by an authority on tuition futures plans reminds us of the idea's virtue: a basic intention to encourage people to plan and save for college. But it does not seem unreasonable to hope that government could promote saving with means less labyrinthine and restrictive.

The current situation certainly exhibits room for initiative. Federal incentives to plan for children's college expenses were indirect from the start. But Congress, in its 1986 tax reforms, either deleted or restricted the traditional incentives (Clifford trusts, Gifts to Minors), leaving means which require considerably more investment acumen.

New York State, in contrast, over the past ten years did attempt to induce saving specifically for higher education, and it did so in a fairly simple way. The Parent's and Student's Savings Plan (PASS) was a tax incentive; it was eliminated in 1987 by an act that adjusted the State's tax structure to the 1986 federal amendments.

A Tax Incentive

There must be limits to offering part of the State's tax base as a mode of State investment, and the recent federal and State tax reforms drew those limits much tighter. With regard to incentives for college saving, however, we suggest not only that it may have been a mistake to eliminate the PASS Plan, but that it has been a mistake of the federal government through the years not to structure its intergeneration transfer tax shelters explicitly to encourage college saving.

The fiscal argument for a college saving incentive is traditional, but still valid: government's additional contribution to higher education in the form of a tax incentive would lever far greater private assets. More important, however, is the public purpose--the economic argument--for this leverage. For in contrast to many purposes for which parents may have transferred income to their children, the college education of a child is the creation of an asset that serves the entire economy and society. Our recommendation for re-establishment of this kind of tax incentive program, then, is also a recommendation that the State offer to the federal government an example of policy which recognizes the public value of college education in the same way that it recognizes the desirability of home ownership, for which tax incentives have long existed and remain.

We recognize that this approach may seem inconsistent with recent federal income tax policy and that federal tax incentives (State taxes being far lower) might be necessary to increase savers' interest. However, the cost of college is clearly a matter of intense national debate, and pressure to alter the federal tax code will be correspondingly intense. In the meantime, states can usefully explore variations in tax incentive programs; a New York State college financing initiative could serve as a model for federal action, as it did relative to guaranteed student loans.

To employ a tuition guarantee program as the incentive for saving would be to start with an incentive that in most forms is not very flexible: It would practically reduce students' choices of college, would be difficult to use for expenses other than tuition, and would subject investors or institutions or both to the potential of significant financial losses if their projections of students' selections and costs of education were inaccurate.

Avoiding the complications of tuition guarantees would make design of an incentive considerably easier, but there still would be choices of consequence. A tax incentive could vary by kind (different combinations of deduction and exemption), size, extent of state administrative involvement, restrictions (regarding withdrawal, transfer of benefits, age of beneficiary and time of use of benefits, and in-state/out-of-state location of colleges), and qualified instruments. The Regents have added a tax incentive proposal to their legislative agenda.

RECOMMENDATIONS

Tuition Futures: A Cautious Development

Our first recommendation regarding tuition futures plans is simple: The Legislature ought not enact a plan in the very near future and should instead consider alternative means of managing the problem of tuition financing.

If the Legislature should decide to establish a guarantee program, we would urge this guideline: Explore all possibilities of making it comprehensive. The plan should not only include both public and independent colleges, but it should also treat their respective primary cost problems: tuition at the independents, room and board at the publics.

Encouraging Planning

We recommend that the Legislature develop means of encouraging parents and others to plan for college costs through vehicles more flexible than tuition futures. We urge the Legislature to investigate and approve a college saving incentive that provides students maximum choice among colleges, creates funds usable for all college expenses, and limits State liability and involvement to that implicit in a tax incentive. We urge it also to direct the State Education Department and the Department of Taxation and Finance to monitor the success of the incentive and, periodically and by specified dates, suggest alterations that might improve its efficiency.

INTRODUCTION

This inquiry is about tuition futures, a college finance technique that involves a guarantee of stable tuition rates in return for payment years in advance. The college invests the advance payment, and it's intended that earnings on the investment will keep up with tuition increases. Tuition futures plans recently have received much press notice, as unusually high inflation in tuition fees has caused anxiety among parents and policymakers. Michigan, Wyoming, Tennesee, Indiana, Florida and Maine have enacted plans.

We find that tuition futures may not be right for New York State. While the idea offers design problems anywhere, it offers a particularly great design problem here. The inter-institutional agreements necessary for tuition guarantees become harder to obtain as the range of tuition fees grows; that range is greatest where the independent college sector is large. One-third to one-half (depending on the specific measure) of New York's college students enroll in the independent sector. Also, most tuition futures proposals ignore expenses for room and board, which in New York State constitute three-fourths of the cost of going to a public college.

Regardless of setting, a key assumption behind tuition futures proposals is increasingly questionable. Tuition futures became a popular idea as the bull market of the 1980s stretched to an unexpected length; proponents could suggest that it was safe to expect average investment returns to keep pace with recent and projected tuition inflation. The massive stock market adjustment of late 1987 suggests that the market may be considerably more volatile than the tuition futures idea can bear. It's now easily conceivable that tuition fees will continue a steep climb as investment earnings slow. Falling stock values threaten not only the practicality of tuition futures, but also the endowment fund growth of many colleges with already fragile budgets; their administrators are unlikely to be comfortable with investment arrangements that seem speculative.

The tuition futures proposition has served to focus discussion on the need to encourage parents to plan and save for their children's college educa-

tion. But while a sound tuition futures plan may not be impossible in New York, it seems an unnecessarily inflexible way to accomplish this purpose. Instead, we suggest that saving for college expenses should be treated as a public purpose that deserves a tax incentive much as home purchasing does.

The recommendations reflect that view, despite its dissonance with recent federal and State tax actions. We suggest that a New York State college financing initiative might again be a model for federal efforts--in this case, efforts to draw more investment toward a highly productive enterprise: college education.

Chapter one provides some context--the recent rate of tuition increases nationwide and in New York State particularly. Chapter two reviews the structure of typical tuition futures proposals, and chapter three describes the implicit bargaining necessary to make a structure work. Chapter four raises the questions of effectiveness and fairness that lead us to suggest a more flexible way of encouraging saving for college education.

CHAPTER 1

THE CONTEXT: RECENT INCREASES IN THE RATE OF COLLEGE COST INFLATION

Paying for college has become a common problem for Americans. This fact is both welcome and unwelcome: It's a happy fact in that it's reasonable for individuals of a great range of means to aspire to go to college; that this aspiration is reasonable is the fruition of decades of national and state policy. It's an unhappy fact in that the problem has never before, in the post-WWII years, been so great; the cost of college has become major, and increasingly it causes anxiety for parents, students and college administrators.

A Focus on Tuition Fees

Accelerated Inflation

It's tuition fees, more than any other college cost, that have been the subject of recent expressions of concern. Research confirms that tuition fees have been rising fast during the 1980s, at double the inflation rate and faster than income. For the six years since fall 1980, tuition fees nationwide have annually risen an average of 9.8 percent. (1)

During the 1970s, the increases had been lower, ranging among the different kinds of institutions (public and independent two- and four-year colleges and universities) from about six percent to about eight percent; the independent institutions' tuitions inflated at a rate about one percentage point higher than did the public institutions'. In the 1980s, the average percentage increases for the publics and independents have been about the same. (Among all kinds of public and independent institutions, the increase at independent universities--11 percent--has been greatest.) (2) But inasmuch as the independents' tuition fees

are higher, the dollar gap between publics and independents has increased, and consequently the press focuses much of its attention to the problem of paying for college on the independents.

Tuition fee increases during the 1970s lagged behind increases in the Consumer Price Index (CPI) and personal income by 1.2 and 2.6 points, respectively; during the 1980s, however, tuition increases have outpaced the CPI and income growth by 4.9 and 3.3 percentage points. (3,4) Whether tuition-fee inflation will continue at this high rate is unknown, but even if the rate declines, there is fear about the effects of the level tuition already has reached. For instance:

- Students increasingly are emerging from college heavily in debt; this remains true even controlling for inflation. A Congressional Joint Economic Committee report indicates that the average rate of indebtedness upon graduation from public colleges in 1986 was $6,685. Average indebtedness at independent schools is even greater, and at both publics and independents, it's expected to increase. (5)

- The loan burden is an economic problem in itself, but the problem may be compounded by the effect it has on selections of college majors. As students worry about their post-graduation job prospects, they may decline to major not only in the liberal arts generally, but also in lower-paying but obviously vital areas such as teaching, nursing and social work. (6)

- The quality of instruction may be in jeopardy, as the colleges use more of their assets to provide additional aid to enrollees and less, therefore, to pay professors and buy books and equipment.

- There may be less aid available for the neediest students. Some colleges, competing for students in what is increasingly a buyer's market, may be using the ever-dearer student assistance to entice enrollment, and they may be doing it with less regard for student need than was formerly the case. (7)

Recent federal changes add to the fear.

- The 1986 tax reform act included provisions that reduce:
  - . the deductibility of interest paid on student loans; and
  - . incentives for charitable contributions, through which independent colleges, especially, obtain operating revenues.

- Federal grants cover a declining percentage of college costs, and federal loan programs are becoming even more predominant. Loan availability, however, has declined somewhat as a result of more stringent requirements to demonstrate financial need.

A Financial Gap

In short, it seems that there is an increasingly large gap between college costs and available resources. This gap occurs despite the enrichment (especially in New York State) of state aid programs. In fact, while aid has increased 23 percent over the last five years, costs have increased so fast that the net effect nationwide has been a three-percent decline in aid. (8)

An obvious way to partly close the gap is the use of family savings. The obviousness of this approach, however, does not make it either welcome to students' families or necessarily available. Many families may never have had incomes sufficient to save for college costs. Other families may have had sufficient incomes, but have not been aware of how widely the gap has been opening. Recently, then, college officials and observers of academic finances have been stressing the need to sensitize parents to the wisdom of planning earlier for their children's higher education and to sensitize government to the wisdom of inducing parents to do such planning. From the standpoint of the institutions, of course, the wisdom of creating and applying savings for higher education is straightforward: they need the money to operate, especially in a nation in which the number of people available to be full-time students is declining.

One Response: Advance Payment of Tuition

Individual and Group Plans, and Complications

Advance payment of tuition is one way by which families' savings can be used toward the education of a child. Advance payment, in fact, has been tried, and continues to be tried, at many individual colleges. These programs, however, are not the kind which this inquiry is addressing. The typical, individual institutional program of advance payment involves paying a lump sum, at the time of matriculation, to the college to cover all of four years' tuition. The college gets the money "up front" to invest or enhance its efficiency; families and students, paying tuition fully at the rate charged at the time of payment, avoid subsequent tuition increases. Sometimes, too, the payers receive a discount (ranging from three percent to ten percent) on the four-year tuition fee.

The kind of advance payment program we will explore here--tuition futures--differs from these individual institutional plans. We are interested in plans whereby:

- payment would buy a stable tuition not just at a single college, but at any of a group of colleges; and
- payment would occur more distantly prior to matriculation, when the prospective student is, for instance, in grade school.

Such a plan would do nothing for families of students who will matriculate in the very near future. Nevertheless, it has attractions: The college group arrangement would permit the students some choice of institutions when they become old enough to matriculate, and it would relieve the parent-investors of some of the stress of trying to predict the kind of college their child will be able and willing to attend. Making payment earlier would permit parent-investors more flexibility in the incorporation of college costs into their personal finances. Payment might be made in a single lump sum or several sums, and it might be made partly or completely out of savings or borrowings. These earlier payments also would give the institutions a longer period in which they could have and manage the money.

The concept may seem simple; upon a closer look, however, we find practical uncertainties that are serious and complicated. For instance:

- For the colleges, parents and students who are parties to tuition futures contracts, there are questions of:
  - . whether colleges' costs of operating are reliably predictable and whether investment interest rates will keep pace with them;
  - . how to apportion earnings on the prepaid amount if the participating colleges reject the student applicant, if the student chooses to go to a non-participating college or not to attend college at all, or if the student withdraws or is expelled;
  - . whether necessary cost cutting will cause, by the time the child reaches college, a decline in the quality of education at the colleges in which the parents are investing; and
  - . whether this form of saving for college will disqualify students from aid for which they would otherwise be eligible.
- Observers, parents and students who are not parties to such tuition futures contracts can understandably be interested in:

. whether colleges, in investing the prepaid funds, will make misjudgments that force tuition fees even higher and, in effect, require other students to subsidize those who prepaid; and

. whether such plans assist colleges in avoiding reasonable cost cutting measures that could dampen the rise in tuition fees.

- Lawmakers in particular must ask why so many proponents of this idea call for the state to establish and operate the plans. Do public colleges need this idea? Can the state become involved without becoming liable for deficits that could result from errors in projecting investment earnings and inflation in college costs and revenues?

Despite these uncertainties, there are many proposals for state-coordinated plans; in Michigan and several other states, such proposals have become law. The uncertainties, however, require resolution, or at least assumptions, on which program designers would depend in creating the specific structures of the plans.

Pervading Concerns: Access and Choice

Access and choice are the widely accepted reasons for which state and federal governments have become involved in student aid programs. New York State, perhaps even more than the federal government, has been a pioneer. With its guaranteed student loans and entitlement assistance ("TAP" is the best known), it has attempted to convey funds to students in a manner and to a degree that ensures that those who wish to go to college can do so, regardless of their means at the time they reach college age. And with its Bundy aid, the State has shown its intention that tuition fees at independent colleges should be kept within reach of a large proportion of the state's residents.

The tuition futures idea combines the objectives of access and choice in a new way, a way that creates something of a contradiction between them. A tuition futures plan can enhance access--it can provide both impetus and means for people of moderate income to ensure that their children can afford college. But a tuition futures plan also can work, both directly and subtly, to inhibit choice: The direct inhibition would be any penalties incurred if a student does not, for any reason, end up going to a college participating in the plan. (The most likely penalty would be partial or total surrender of interest earnings on the prepaid amount.) The more subtle inhibition would be the communication of <u>fait accompli</u> for a student that could occur as a consequence of parents' enrollment in a plan.

One of the problems at the heart of the policy question of tuition futures, then, is finding an acceptable combination of access and choice. And if the State sponsors a plan, then it should be acceptable not only to participating families and colleges, but also to nonparticipating families and other taxpayers. Most of this inquiry will focus on the problem of finding an optimum; we might obtain a clearer focus if we turn first to describing the financial context of higher education in New York State.

The New York State Context

To be credible, an account of the status of college financing in New York State ought to be somewhat complicated; questions of college financing involve several factors, several perspectives and several different needs.

- The factors are tuition and fees, State student aid, federal student aid, State institutional aid, federal institutional aid, college costs, the cost of living, and family income.
- Different parties have different needs in the college marketplace.
    - Parents and students need ways to pay for college and, in general, wish the costs were lower.
    - The colleges need enrollments (a reason to hold down tuition fees) and revenue to deal with rising operating costs (a reason to raise tuition fees). Administrators in the different sectors (the 64 State University campuses, the 19 City University campuses, the 115 independent institutions and the 24 proprietary colleges) may, because of differences in funding sources, feel these needs to different degrees.
    - The State needs a substantial base of well-educated citizens in order to obtain economic development, and it needs to represent third parties (e.g., the taxpayers) in negotiations over the factors of college finance.

It's easily conceivable that answers to the question, "How's it going?" would differ depending on which of these parties you were asking, and it might differ from student to student or from college official to college official depending on whether the institution involved was independent or public. In the case of the State's needs, the answer might also be "I'm not sure," because data necessary to answer the question in relation to the State's more subtle needs are sparse, at best.

Vehicles of Government Assistance

Trends in State and federal aid are critical to an account of the status of college financing. Some readers are not familiar with the different ways by which governments convey money to colleges; for them, the following brief description may be a useful prelude to the few statistics we will shortly present. Those who are familiar with higher educational aid might well skip this description.

The categories of "institutional assistance" and "student aid" are useful to distinguish the manners in which government spends money on higher education. It should be remembered, however, that institutional assistance--money conveyed directly to a college for its operations--does help students and their families to finance education by helping the college to hold down tuition fees. And student aid can be understood as a stream of money on which institutions depend.

State Assistance--New York State assistance occurs mainly in these categories:

- Institutional Aid

  . State University of New York--The 64 campuses received about $2.3 billion in fiscal year 1987. (9) Figure 1 exhibits the range of activities on which SUNY spent this money.

  . City University of New York--The State shares funding responsibility for CUNY; in fiscal year 1987, it provided about $1.6 billion, which CUNY spent on a range of activities similar to that of SUNY. (10)

  . Bundy Aid--The State Education Department conveys unrestricted aid to independent colleges in accordance with the number and types of degrees awarded each year. An independent college receives up to $600 for an Associate's degree, $1,500 for a Bachelor's degree, $950 for a Master's degree and $4,550 for a Doctor's degree. The amount of Bundy aid an institution receives varies with the year-to-year number and configuration of degrees it awards, and the State's annual allocation for Bundy aid varies with the year-to-year number and configuration of degrees in the independent sector. In fiscal year 1987, Bundy aid came to about $114 million. (11)

  . Various other categories include facilities financing through the State Dormitory Authority and Housing Finance Agency, medical and dental capitation, reimbursement for the non-federal portion of work-study payments, and support for science and humanities chairs.

Figure 1

State University Expenditure Categories

State Operations

Instruction and Departmental Research

Academic Related Services (Organized Research, Extension and Public Service, Organized Activities and Libraries)

Student Services

Institutional Support Services

Hospitals and Clinics

Dormitory Operations

Programs Administered by the State University

New York Network

Programs for Educationally and Economically Disadvantaged

Educational Opportunity Program

Educational Opportunity Centers

Minority Recruitment and Retention

University-Wide Programs

Academic Equipment

Equipment Replacement

Engineering Equipment

Building Repairs

Canine Research

Municipal Contracts

Child Care Centers

College Work Study

Comprehensive Computer Upgrade Program

Computer Access

Intercampus Data Network

Library Automation

Coordinated Collection Development

The Empire State Institute for the Performing Arts

Organized Research

Graduate Fellowships

Small Business Development Centers

Indirect Cost Waivers

Internal Audit

Statistical Yearbook

Engineering Faculty

Library Conservation Program

Geriatrics Chair

New York State Writers' Institute

Program in the Arts

State University Supplemental Tuition Assistance

Tuition Reimbursement Program

University Computer Center

University-Wide Governance

University-Wide Student Access Services

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- Student Aid--The State (largely through the Higher Education Services Corporation) makes payments on behalf of specific students in the following categories:

  . Tuition Assistance Program--TAP awards are entitlement grants based on family income and the tuition a student is paying. To qualify, a student must attend a college within New York State. The annual awards range from $100 to $2,850. Most students are eligible for four years of assistance (in certain programs, eligibility is for five years). The Supplemental Tuition Assistance Program (STAP) provides an additional year of aid for educationally disadvantaged undergraduates. Projected expenditures for TAP/STAP in fiscal year 1987 were somewhat more than $386 million; the projected number of recipients was somewhat more than 281,000. (12)

  . Scholarships and Fellowships--New York State provides many thousands (by one estimate, more than 100,000) scholarships, fellowships and special awards to promote excellence and induce enrollment in certain areas. (13) Examples of general merit awards are Empire State Scholarships of Excellence and Lehman Fellowships. Examples of inducements in specific areas are Regents College and Nursing Scholarships, Carl D. Perkins Scholarships and Empire State Challenger Scholarships and Fellowships (for those who intend to become teachers), the Regents Loan Forgiveness Program (for prospective physicians) and Health Services Corps Scholarships and Fellowships (for preparation in other health care professions).

  . Aid for Part-Time Study--Income-based grants of up to $2,000 are available to residents who engage in part-time college study within the state. Qualifications have resulted in the typical award being much less than the maximum (often only several hundred dollars). (14)

  . Opportunity Programs--Four separate but similar programs provide assistance for students who are academically or economically disadvantaged. This limited assistance is rendered at the discretion of college finance officers. The program at the State University campuses is called the Educational Opportunity Program (EOP); at the City University's four-year schools, it's Search for Elevation and Education Through Knowledge (SEEK); at the City University's two-year schools, it's College Discovery (CD); and at the independent colleges, it's the Higher Education Opportunity Program (HEOP).

  . Various other categories include aid to Native Americans, State Guaranteed Student Loans (a program which is being phased out), and a work incentive program which assists recipients of Aid to Dependent Children with expenses for vocational education. The State Dormitory Authority funds and administers a Supplemental Higher Education Loan Financing (SHELF) Program. SHELF I spans the gap between the total of other assistance and the costs of attendance at participating colleges. SHELF II is a prepayment plan: the Dormitory Authority funds loans through which stu-

dents may obtain up to four years of tuition at the current rate at participating colleges. Due to matching fund requirements for the participating institutions (and perhaps also due to the interest rates involved), the SHELF programs are not large.

Federal Assistance--Federal assistance for higher education became important after World War II; its predominant form is student aid. The law that authorizes most federal assistance is the Higher Education Act of 1965; Congress has amended this act several times, altering existing programs, adding others and extending the life of the Act. The most recent amendments and extension occurred in 1986. Federal aid to institutions supports:

- development of libraries and other academic facilities;
- migrant aid, provision of child care and other special services for disadvantaged students;
- creation and development of programs of continuing and cooperative education;
- programs of college assistance for community development; and
- programs of international education.

Federal student aid is by far the nation's greatest single source of higher educational assistance; it is almost entirely need-based.

- Guaranteed Student Loans--This loan program has become the federal government's chief higher educational commitment. Until the 1986 amendments, only borrowers whose families earned more than $30,000 were required to undergo a financial needs test; now all applicants must undergo such a test. It's somewhat simplistic, but not inaccurate, to say that the fundamental idea of the program is to induce private lenders, through interest rate subsidies and guarantees, to make loans to students. The amount of indebtedness which the federal government underwrites varies by formula from state to state. Administrative responsibility is chiefly with designated state authorities and campus financial officers. There are limits, ranging from $2,500 to $7,400, on the annual amount students can borrow. Limits on total indebtedness range from $25,000 to $54,750. Borrowers have ten years to repay the loans.

- PLUS and ALAS--Additional borrowing of up to $3,000-4,000 per year is available through Parent Loans for Undergraduate Students (PLUS) and Auxiliary Loans to Assist Students (ALAS). PLUS loans have no interest subsidy.

- National Direct Student Loans--This program was established in 1958 as part of the National Defense Education Act; the loans used to be called National Defense Student Loans. The program's administration differs from that of other federal loan programs in that participating colleges directly contract with the federal government (rather than via a designated state authority) to obtain loans for specific need-qualified students and must provide a ten-percent match. Annual loan limits range from $3,000 to $4,500 for the first two years; total indebtedness limits range up to $18,000. The interest rate is five percent.

- Pell Grants--Also known as Basic Educational Opportunity Grants, and formerly the chief federal student assistance program, these need-based awards theoretically can range up to $2,300 for the 1987-88 academic year. In practice, however, Pell Grants usually are several hundred dollars less than the maximum. (15) Additional grant aid known as SEOG (Supplemental Educational Opportunity Grant) is available to those who satisfy the need criteria.

- State Student Incentive Grants--The federal government established this program to induce states to create or enlarge scholarship and grant programs. The inducement is the provision of federal monies for amounts of up to half of the total award for each student.

- College Work-Study--The federal government allocates monies to colleges to employ students (low-income applicants are preferred) at the college or at public or non-profit agencies. Starting with the 1988-89 school year, the portion of federal funds that colleges must match will increase in two steps from 20 percent to 30 percent.

The Changing Configuration--New York State's support of higher education through appropriations for institutions and students has been pioneering and large. Its annual appropriations for college operations and student aid well exceed $2 billion, and this figure does not include capital construction assistance. (16) New York's assistance to students, in fact, far exceeds the combined total provided by the next three highest states (California, Illinois and Pennsylvania), and in 1986-87 constituted more than one-fourth of the total amount of student aid given by all the states. (17)

But despite the State's relatively massive effort, the amount of assistance New York's collegians receive from the State is only about one-fourth of the amount they receive from the federal government. (18) It's understandable, then, that changes in federal policy and appropriations sometimes can buffet students, parents and colleges--including the public colleges, but especially the independent colleges--even more than changes the State might make. Declines and other changes in federal assistance can create needs and pressures for states to provide even more assistance than they do currently.

Two basic movements have, over the past ten years, increased stress on those involved with financing college education.

- The federal government's assistance to higher education increasingly takes the form of loan underwriting; the proportion of its commitment to grant programs has declined and apparently will continue to decline. (19)

- Inflation of college costs, which lagged behind general inflation during the 1970s, has in the 1980s caught and surpassed general inflation.

This combination of changes has been felt, and will continue to be felt, by all the other participants--parents, students, colleges, and the State--in their efforts to cover the costs of higher education.

- Parents are digging deeper into savings and incurring more indebtedness.

- Many college administrators, aware of increasing stress, are trying to hold down costs. Many colleges are redirecting more institutional resources to student aid. This can bring operating deficits and cost cutting that conceivably could damage the quality of education at some institutions.

- The State has enriched its student aid programs and generally increased its support of higher education.

- Students are borrowing more; despite the increased efforts of parents, colleges and the State, students are emerging from college with more debt.

An additional source of stress on the colleges is a decline in the number of people of the typical college-going age. The Regents report that by 1992, the population aged 15-19 years will have declined by 24 percent, and the population aged 20-24 years by 13 percent. (20)

Tuition Trends in New York State

Tuition fees usually are the central point in the discussion of higher educational finance. This is sensible in that tuition fees can be understood as a summary of the relationship between a college's costs and available resources to cover them: The more the college's costs exceed the total of state aid, federal aid and endowment, the higher must tuition fees be in order for the college to operate without a loss. If the sum of revenue available from other

sources (including the amount saved from either reasonable or quality-damaging cutting of costs) rises slower than do costs, then tuition fees too must rise.

A simplistic focus on tuition fees, however, can be misleading; discussants should be consistently aware that a tuition fee does not simply represent an amount necessary to cover the college's costs divided by the number of enrollees, but rather a complex margin created by trends in government aid, tax law (through effects on charitable contributions), general inflation, and sometimes especially high inflation in specific college cost categories such as faculty salaries and benefit packages.

With that caveat, we might use tuition trends as the center of a sketch of "how it's going" in New York State higher educational finance. We can, for instance, review trends in tuition fees alone and vis-a-vis general inflation, inflation in colleges' costs of operating, government assistance, and per capita income. (The following analysis will concentrate on a comparison of the two largest segments of higher education institutions: the State University and independent colleges. It might be noted, also, that the sources and structure of City University finances have been so changed in recent years by State assumption of funding that comparison might as often be misleading as enlightening. The proprietary colleges' cost increases, while perhaps consonant with nationwide and statewide trends, are rarely the subject of the recent concern over college costs; less than one percent of New York's college enrollment is at the proprietaries.)

Tuition Fees Alone--Tuition fee increases have been larger at the independent colleges. Not only do independent colleges' percentage increases exceed those of public colleges, but their base amounts--the tuition levels on which those percentage increases occur--are higher. In such comparisons, it's important always to remember that the publics' tuition is subsidized by massive State institutional aid; the independents must depend far more on tuition fees.

From 1975 to 1985, tuition fees at the independents increased by 144 percent; at the State University (SUNY), they increased by 102.5 percent. From 1980 to 1985, the figures, respectively, were 66.1 percent and 46.8 percent; the increase at the City University (CUNY) was 33.7 percent. The average level of tuition and fees at the independents increased from $2,763 in 1975 to $6,741 in 1985; at SUNY, the increase was from $720 to $1,458. (21) (See table 1.) In these, as well as subsequent figures, there is some variation among the different kinds of independent colleges (multiversities, college complexes, health sciences

centers) and also among the different kinds of State University campuses (university centers, statutory colleges, community colleges).

Tuition Vis-a-Vis General Inflation--During the five-year period leading up to 1985, the tuition increases at both SUNY and the independent colleges exceeded the increase in the consumer price index (CPI) for New York State urban areas. The respective percentage increases in tuition fees of 46.8 and 66.1 outran the CPI increase of 36 percent. (At CUNY, the five-year increase of 33.7 percent was slightly less than the increase in CPI.) (22)

Another way to measure the rate of tuition increases against general inflation is to statistically compensate for it, i.e., to subtract from the colleges' figures the amount due to general inflation. In constant dollars, then, the percentage increase from 1975 to 1985 at SUNY was 7.2, while at the independent colleges it was 29.1 From 1980 to 1985, the constant-dollar percentage increases at SUNY, CUNY and the independents were, respectively, 11.5, 1.5 and 26.1. (See table 2.)

Tuition Vis-a-Vis College Costs--Some public officials who over the past few years have objected to the sizes of tuition increases suggest that administrators operate their colleges less efficiently than they ought to. There is concern that avoidable increases in the cost of educating a student are causing tuition inflation.

There would be plenty of room for argument even if the debaters were concerned only with the problem of measuring this cost. They generally focus, however, on questions that are even more complicated and that depend on resolving the measurement problem.

- They argue about the relationship of cost to quality; and
- they try to construe the fact that massive state subsidies at the public colleges means that there is no necessary relationship between costs and tuition.

The debate will not soon be resolved by research, for the basic problem of measurement is great. Colleges' accounting conventions probably are even more diverse than their administrative structures. All accounting involves some allocation of costs across expenditure categories--essentially, accountants' judgments rather than simple measurement. These judgments are made more complicated by the fact that some colleges' expenses are partly absorbed by a central entity (like SUNY Central) while other colleges operate with complete indepen-

Table 1

Average Tuition and Required Annual Fees Weighted by Full-time Undergraduate Enrollment 1975, 1980, 1983-85

Current Dollars

Weighted Average Tuition and Fees Sector/Type	1975	1980	1983	1984	1985	Percent Change 75-85	Percent Change 80-85	Percent Change 84-85
New York State	$1,277	$2,239	$3,107	$3,391	$3,667	187.2	63.8	8.1
State University	720	993	1,366	1,427	1,458	102.5	46.8	2.2
University Centers	726	1,029	1,468	1,514	1,483	104.3	44.1	-2.0
University Colleges	757	1,005	1,460	1,463	1,470	94.2	46.3	0.5
Health Sciences Centers	857	1,035	1,454	1,530	1,471	71.6	42.1	-3.9
Specialized Colleges	739	963	1,510	1,488	1,475	99.6	53.2	-0.9
Statutory Colleges	1,593	2,333	3,554	3,867	4,166	161.5	78.6	7.7
Agricultural & Technical	764	1,035	1,481	1,487	1,483	94.1	43.3	-0.3
Community Colleges	620	877	1,106	1,191	1,245	100.8	42.0	4.5
City University	0	986	1,289	1,317	1,318	***	33.7	0.1
Senior Colleges	0	987	1,292	1,331	1,334	***	35.2	0.2
Community Colleges	0	984	1,283	1,289	1,289	***	31.0	0.0
Independent Institutions	2,763	4,059	5,666	6,198	6,741	144.0	66.1	8.8
Multiversities	3,470	5,338	7,614	8,223	9,010	159.7	68.8	9.6
Universities	2,590	3,679	4,870	5,350	5,765	122.6	56.7	7.8
College Complexes	2,920	4,352	6,153	6,678	7,329	151.0	68.4	9.7
Colleges	2,319	3,114	4,211	4,657	4,988	115.1	60.2	7.1
Specialized Colleges	2,468	3,837	5,530	5,467	5,915	139.7	54.2	8.2
Engineering & Technical	2,546	3,994	5,829	6,392	6,968	173.7	74.5	9.0
Seminaries	1,939	2,473	2,861	2,895	3,195	64.8	29.2	10.4
Health Sciences Centers	2,025	2,197	3,430	3,980	4,390	116.8	99.8	10.3
Nursing Schools	***	2,584	3,115	3,046	3,495	***	35.3	14.7
2-Year Institutions	2,088	2,716	3,621	3,988	4,426	112.0	63.0	11.0
Proprietary Institutions	$1,812	$2,821	$3,688	$3,980	$4,318	138.3	53.1	8.5

Source: New York State Education Department, Bureau of Postsecondary Research and Information Systems, September 1986.

Table 2

Average Tuition and Required Annual Fees Weighted by Full-time Undergraduate Enrollment 1975, 1980, 1983-85

Constant Dollars, 1975 Base Year

Weighted Average Tuition and Fees Sector/Type	1975	1980	1983	1984	1985	Percent Change 75-85	Percent Change 80-85	Percent Change 84-85
New York State	$1,277	$1,561	$1,785	$1,864	$1,941	52.0	24.4	4.1
State University	720	692	785	784	772	7.2	11.5	-1.6
University Centers	726	717	843	832	785	8.1	9.4	-5.7
University Colleges	757	701	839	804	778	2.8	11.1	-3.2
Health Sciences Centers	857	721	835	841	779	-9.1	7.9	-7.4
Specialized Colleges	739	671	868	818	781	5.7	16.3	-4.5
Statutory Colleges	1,593	1,626	2,042	2,125	2,205	38.4	35.6	3.8
Agricultural & Technical	764	721	851	817	785	2.8	8.8	-3.9
Community Colleges	620	611	635	655	659	6.3	7.8	0.7
City University	0	687	741	724	698	***	1.5	-3.6
Senior Colleges	0	688	742	732	706	***	2.6	-3.5
Community Colleges	0	686	737	708	682	***	-0.5	-3.7
Independent Institutions	2,763	2,829	3,255	3,407	3,568	29.1	26.1	4.7
Multiversities	3,470	3,721	4,374	4,520	4,769	37.4	28.2	5.5
Universities	2,590	2,565	2,798	2,941	3,052	17.8	19.0	3.8
College Complexes	2,920	3,034	3,535	3,670	3,880	32.9	27.9	5.7
Colleges	2,319	2,171	2,419	2,560	2,640	13.9	21.6	3.2
Specialized Colleges	2,468	2,675	3,177	3,005	3,131	26.9	17.1	4.2
Engineering & Technical	2,546	2,784	3,349	3,513	3,689	44.9	32.5	5.0
Seminaries	1,939	1,724	1,644	1,591	1,691	-12.8	-1.9	6.3
Health Sciences Centers	2,025	1,531	1,971	2,188	2,324	14.8	51.7	6.2
Nursing Schools	***	1,801	1,790	1,674	1,850	***	2.7	10.5
2-Year Institutions	2,088	1,893	2,080	2,192	2,343	12.2	23.7	6.9
Proprietary Institutions	$1,812	1,966	2,119	2,188	2,286	26.2	16.2	4.5

Source: New York State Education Department, Bureau of Postsecondary Research and Information Systems, September 1986.

dence. And still other colleges, while mostly independent, are involved in consortia to provide student services (e.g., intercampus bus lines).

While existing measures are not considered adequate to resolve the debate, a look at two current measures of college costs might indicate the nature of the research necessary.

- The Higher Education Price Index (HEPI) is a nationwide composite describing a fixed set of expenditures including salaries for faculty and other staff, technical services, contracted services, supplies and utilities. The baseline year is 1971-72; increases are measured since and against the index figure for that school year. The State Education Department suggests that if there were a HEPI strictly for New York State, its recent trend probably would not differ greatly from the trend of the nationwide HEPI. (23)

- Student-related educational expenditures (SRE) "represents those costs directly related to the education of the student. The major component of SRE expenditures is the cost of instruction. The remainder, the non-instructional costs, are composed of items such as student services, libraries, administration, and the operation and maintenance of the educational plant." (24)

Using a measure like HEPI, we could compare college sectors' tuition increases only against a nationwide average; using a measure like SRE, we could compare the sectors' tuition increases with sector-specific measures of cost. For instance, the HEPI, during the first half of the 1980s, increased by 46 percent--about 12 points more than the increase in the CPI. (25) Increases in SUNY's tuition fees--46.8 percent--approximately matched HEPI increases, but the independent colleges' increases exceeded that of the HEPI by about 20 points.

The HEPI represents the costs at a cross-section of colleges, and one possible reason for any sector's tuition increases exceeding HEPI increases could be that its operating expenditures increased more than did college operating costs generally. This hypothesis could be checked through an examination of SRE. For instance, the SRE increases in the first half of the 1980s were 48 percent at SUNY and 63 percent at the independent colleges. (26) SUNY's increase, then, was similar to that of the HEPI; the independents' increase exceeded the HEPI by about 17 points. So it would appear from this kind of comparison that tuition increases at both SUNY and the independents approximated cost increases.

Were such comparison reliable, it would then be helpful, and perhaps important, to understand why the independents' costs of instruction rose at a pace noticeably faster than average. One obvious possibility would be that

education at independent colleges is better; another would be that it's inefficient. A less obvious possibility, however, would have to do with a kind of deferral of maintenance. It has often been noted that tuition fees increased slower during the 1970s than did the CPI and that these good times for the consumer of college education depended on a lag in faculty salary increases. (Others would note, however, that a truer assessment would include benefit packages and that the overall compensation lag might not have been so great.) It's often suggested that the tuition increases during the first half of the 1980s happened because colleges have simply been "catching up." Perhaps the 1970s lag at New York's independents was greater--they had more catching up to do.

Tuition Vis-a-Vis Other Revenues--As college costs have increased, so has college revenue, but smaller increases in some forms of revenue have required greater increases in other forms. Statewide, the percentage of total college revenues constituted by State aid has been stable during the first half of the 1980s, but the percentage of revenues constituted by federal institutional aid declined, from 14 percent to 11 percent. (See table 3.)

Table 3

Current Fund Revenues by Source and Shares of Major Current Fund Revenue Categories
Degree-Granting Institutions

	New York State Totals ($ millions)			
	1981		1985	
	$	(%)	$	(%)
Tuition and Fees	$1,894	(35)	$2,904	(38)
Federal	728	(14)	865	(11)
State	1,504	(28)	2,186	(28)
Local	398	(7)	470	(6)
Private Gifts and Contracts	354	(7)	550	(7)
Endowment Income	204	(4)	312	(4)
Miscellaneous	263	(5)	388	(5)
Subtotal-Common Sources	$5,345	(100)	$7,675	(100)

Source: Adapted from the New York State Education Department's Fiscal Indicators for Postsecondary Education in New York State, 1980-81 Through 1984-85, DRAFT, February 1987, p. 16.

The trends at independent colleges, however, differ importantly from the general trend: At independents, the percentage of revenue constituted by federal aid declined by a point more--from 19 to 15--than it has generally, and State institutional aid increased less than it has generally. Institutional aid increases for public schools ranged from 37 to 41 percent, while for the independents the increase was 13 percent. (27) State institutional aid to independents (Bundy Aid), as a percentage of SRE, declined from about 5 percent to 4 percent. (28)

State institutional aid increases in all sectors lagged behind the increases in HEPI and SRE. But while the lag was less than 10 points among the SUNY schools, it was considerably more--on the order of 35-50 points--among the independents. It's no surprise, then, that while the percentage of revenue constituted by tuition fees at SUNY remained at 15 (and it actually declined, from 20 to 19, at CUNY senior colleges), it increased from 48 to 52 at the independents. (29) (See table 4.)

While the student aid portion of public monies for higher education has increased, there is evidence that a gap between costs and aid has developed and widened. The Regents, for instance, concluded that "the growth in student assistance in recent years has failed to keep pace with inflation. According to an estimate by the Higher Education Services Corporation, the real value of total student aid from government sources, adjusted for inflation, declined by 21 percent between 1980 and 1983." (30) The State Education Department (SED) likewise found a decline in real aid.

> Increases in TAP and Pell did not keep pace with increases in college costs; college costs rose by between $1,300 and $3,400 between 1981-82 and 1983-84, while the maximum Pell increase (at $9,000 family income) was $350 and the range of TAP increases was between $50 and $650 (depending upon family income and the institution attended). (31)

The independent colleges have attempted to compensate by increasing their own student aid: Student aid provided from independents' campus revenues increased 57 percent during 1980-85. (32)

College Costs Vis-a-Vis Income--Independents' tuition increases seem, as they do nationwide, to have been greater than income increases. Direct comparisons of tuition increases and income increases appear not to be readily available. SED, however, in 1985 completed a helpful study of students' college

Table 4

Total Current Fund Revenues by Source and Shares of Major Current Fund Revenue Categories by Source By Sector-Degree-Granting Institutions ($ millions)

	SUNY				Independent			
	1981		1985		1981		1985	
	$	(%)	$	(%)	$	(%)	$	(%)
Tuition and Fees	$ 193	(15)	$ 272	(15)	$1,399	(48)	$2,168	(52)
Federal	124	(10)	170	(9)	542	(19)	643	(15)
State	875	(68)	1,218	(67)	139	(5)	165	(4)
Local	9	(1)	20	(1)	130	(5)	180	(4)
Private Gifts & Contracts	39	(3)	74	(4)	301	(10)	453	(11)
Endowment Income	5	(0)	9	(1)	198	(7)	299	(7)
Miscellaneous	47	(4)	58	(3)	182	(6)	284	(7)
Subtotal-Common Sources	$1,292	(100)	$1,821	(100)	$2,891	(100)	$4,192	(100)

Source: Adapted from the New York State Education Department's Fiscal Indicators for Postsecondary Education in New York State, 1980-81 Through 1984-85, DRAFT, February 1987, pp. 17-18.

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costs. The measure of these costs in the SED study covered not only tuition, but also room and board. From 1976-77 to 1983-84, students' costs at independent institutions increased about 90 percent; at SUNY, they increased about 74 percent. Median family income also increased about 74 percent during that period--about the same as students' costs at SUNY and about 15 points less than at the independents. SED, to control for the effect of general inflation, also developed cost and income figures in constant dollars. The cost increase at independents was 9-10 percent; at SUNY, costs were virtually stable--.5 percent. Meanwhile, median family income in New York also rose only .5 percent. (33) (See table 5.)

It's difficult to compare trends in income and tuition only; years for which the U.S. Census Bureau has estimated per capita income do not precisely align with the period for which we have tuition figures. Nevertheless, some

Table 5

Students' College Costs and Median Family Income New York State 1976-77 to 1983-84

Current Dollars

Year	Average Cost of Attendance			Median Family Income
	Independent Universities	Independent Colleges	SUNY	
1976-77	$4,952	$4,456	$2,333	$15,037
1977-78	5,258	4,741	2,405	16,541
1978-79	5,725	5,085	2,462	18,691
1979-80	6,201	5,533	2,685	19,913
1980-81	6,841	6,103	2,937	21,599
1981-82	7,676	7,039	3,330	23,000
1982-83	8,614	7,756	3,556	24,781
1983-84	9,367	8,510	4,068	26,198

Constant 1982 Dollars

Year	Average Cost of Attendance			Median Family Income
	Independent Universities	Independent Colleges	SUNY	
1976-77	$8,141	$7,326	$3,835	$24,721
1977-78	8,103	7,306	3,706	25,490
1978-79	8,067	7,165	3,469	26,243
1979-80	7,708	6,878	3,337	24,752
1980-81	7,628	6,805	3,275	24,083
1981-82	7,876	7,222	3,417	23,598
1982-83	8,468	7,624	3,496	24,360
1983-84	8,880	8,067	3,856	24,836

Cost of attendance includes tuition, required fees, room and board estimated for the independent sector from 1976-77 to 1980-81. Costs are averages weighted by full-time undergraduate enrollments for independent 4-year-or-more and public 4-year-or-more residential campuses. Median family income is total money before taxes.

Source: Adapted from the New York State Education Department's Net Cost of Student Attendance at Postsecondary Institutions in New York State, December, 1985, p. 14.

inference is possible. It appears that per capita income in New York State has been rising fast enough to keep up with tuition increases at the public colleges, but not fast enough to keep up with tuition increases at the independent colleges. From 1979 to 1983, per capita income rose 35.8 percent. (34) Assuming a continuing rise, it's likely that the increase in per capita income would have approximated and perhaps exceeded the 46.8 percent rise in SUNY tuitions during the years 1980-85; it's less likely that a continuing rise in per capita income would have been sufficient over the years 1984-85 to match the increase in independent colleges' tuitions, 66.1 percent during the years 1980-85.

A Net Result: Rising Student Indebtedness--Sketchy data, then, do suggest revenue and cost changes that have especially pressed independent colleges, which receive little State institutional aid, to raise tuition fees.

Certainly declines in the share of college revenue constituted by federal and State aid have something to do with that pressure. Perhaps as significant as the total volume of aid, however, are changes in the typical form of aid: increasingly, federal aid (which is largely student aid) has taken the form of loans. The generally accepted impression is that students are emerging from college more seriously in debt than did students of a few years ago. The Regents, upon comparing the trend of grants with that of loans, concluded that there is "a growing reliance on loans as a source of student assistance that is potentially an over-reliance." (35)

SED found that average student indebtedness in New York exceeded the national average in 1976-77 by $382 and in 1983-84 by $413. (36) SED also found "an average cumulative four-year total for borrowers of $6,000 at CUNY, $7,500 at SUNY and almost $8,500 at independent sector institutions." (37) Average borrowing at independents exceeds that at SUNY less than one might expect from a simple comparison of tuition levels; this probably is evidence of the extent to which independents have used their campus revenues for student aid.

As of 1983-84, the percentage of total student assistance constituted by loans was 56.9. (38)

Can Tuition Futures Be Significant?

Probably most observers would not call the current situation an emergency or a crisis. Most would agree, however, that rising tuitions are indeed a problem for some institutions and for some students and their families. The

problem at New York's independent institutions is greater than it is at the public institutions. At the public colleges, State aid has escalated in reasonable proportion to cost increases, and tuition increases have not significantly exceeded increases in people's typical incomes. Neither of those conditions holds at the independent colleges: there, tuition is increasing faster, partly because tuition must cover a growing proportion of college operating expenses as well as greater amounts of student aid provided by the colleges.

As a consequence, there is stress: More and more, students who wish to attend college cannot be confident of being able to afford it. College administrators are increasingly mindful of the need to cut costs in order to hold down tuition increases while the enrollment pool declines, and administrators at independent colleges must devise more ways to divert college revenues to college funded student aid. Students in public and independent colleges are emerging increasingly in life-affecting debt. If the revenue gap covered by tuition continues to open, some students who today would attend independent colleges will attend public colleges--choice will practically have declined. And worst, it seems possible that some students from low-income families--students for whom aid used to be sufficient to enable them to attend college--will decline to attend because they won't think they can carry that part of the financing burden which falls on them and their families.

Can tuition futures plans be significant in our efforts to reduce these stresses? That depends on the feasibility of the plans, the size of the student population to which they are directly pertinent, the success of colleges' efforts to control costs, and future trends in government aid. In chapters 2 and 3, we will explore features and problems inherent to tuition futures plans; in chapter 4, we will open some questions about the possible effectiveness and fairness of these plans.

CHAPTER 2

A REVIEW OF TUITION FUTURES PROPOSALS

Accelerated Payment Plans

From Paying Later to Saving Earlier

The recently rapid rise in college costs and alterations in federal aid have led to fear among both parents and college administrators. In response, institutions have devised a variety of alternative financing techniques.

According to an alternative tuition financing monograph by the National Association of College and University Business Officers (NACUBO), current alternative financing plans fall into two categories:

- delayed payment plans, which require incremental payments over the course of a semester, a year, or several years; and
- accelerated payment plans, which require payment years in advance or just prior to enrollment. (1)

The basic idea of accelerated payment plans is that of families planning and saving for the higher education of their children. With the increasing unwieldiness of student debt and the reduction in federal grants, this "save now for the future" approach, as opposed to "pay back later," is quickly gaining nationwide attention.

NACUBO cites four accelerated payment plans: prepayment or guarantee plans, tuition stabilization plans, tuition gift certificates and tuition futures. Prepayment and stabilization plans are shorter-term arrangements, undertaken at the time the student registers in college. Investment in gift certificates and tuition futures plans, which guarantee a fixed, prepaid tuition rate,

can begin as early as at the birth of the child. The prediction involved in these longer-term arrangements is far more difficult than in the shorter-term plans, so they are more complicated. However, potential savings for families could be significantly greater in the long-term plans.

What follows is a brief description of the four accelerated plans. It should be noted that the terms "prepayment," "guarantee," "stabilization" and "futures" have been used interchangeably by different sources. To prevent confusion, the nomenclature used throughout this report is NACUBO's.

Prepayment Plans

Prepayment plans specify that four years of tuition are paid at or just prior to the time a student begins college. Tuition is set at the student's first-year rate, so any increases that occur during the time the student is in school are avoided. The prepayment amount is usually a lump sum. (2)

Given the rate at which tuition is rising each year, it appears that such short-term prepayment could be advantageous to the consumer. On the other hand, paying four years of already-inflated tuition in one sum is unmanageable for many without the help of loans--loans that could prove too burdensome under recent federal tax reform. The loss of interest deduction, in fact, could make impractical any accelerated plan that requires heavy borrowing. (3)

Tuition Stabilization

Tuition stabilization plans, like prepayment plans, guarantee a set tuition rate, but they avoid the lump-sum payment of four years of tuition. Instead, the consumer pays a deposit or premium. For instance, a student might pay a somewhat higher tuition (perhaps a three-percent premium) the first year. Alternatively, the student might deposit an amount--several thousand dollars--with the college upon enrollment. The college would invest the deposit and keep the interest; upon graduation, the student would regain use of the deposit. In return, the student's tuition rate would remain at the freshman level for four years. A stabilization plan might include room and board, and payment could be made semester-by-semester. (4)

Of the 240 institutions in NACUBO's survey, 51 independent and 3 public institutions offered tuition prepayment or tuition stabilization.

Tuition Gift Certificates

A few institutions sell gift certificates to cover some or all of future tuition. One can purchase a certificate for any student--people can even purchase certificates for themselves. At Michigan's Calvin College, the first institution to offer this option, the certificate amount is based on specified tuition units, such as credit hours; the value of the certificate, therefore, keeps pace with rising tuition costs. So a purchaser, by buying a full four years of tuition, need not worry about paying more later. (5) Certificates can be purchased as early in advance as the birth of the child and currently cost $56.50 a unit; a year's tuition, $5,650, equals 100 units. (6)

A problem with gift certificates is their inflexibility. Once a certificate is bought, it's bought: If a certificate is not used, the only recourses available to the holder are to sell the certificate or donate it to the institution's scholarship fund and count it as a charitable deduction. For the institution, gift certificates are risky because they lock-in a student's tuition over a potentially long period. If it's necessary to raise tuition fees rapidly, the institution can lose more money in foregone tuition fee revenue than it gains in the transaction. However, the college cuts down on its risk by refusing to refund unused certificates.

Gift certificates do not cover room and board, but can cover other educational expenses, such as books. (7) In NACUBO's survey, three independent and four public institutions offered gift certificates.

Tuition Futures

Tuition futures is probably the most discussed of all the alternative financing options. Under this plan, a family pays a predetermined sum years in advance of a child's matriculation. The college invests this sum and intends that the appreciation on that investment will keep pace with inflation in tuition. Whether or not it actually does keep pace, coverage of the student's future tuition is guaranteed; the family need not make up the difference.

Each of the other accelerated payment devices anticipates in one way or another the problems and risks of tuition futures plans. With prepayment and stabilization plans, a major concern is coming up with substantial lump-sum payments (some might borrow to do so). With gift certificates, a major concern is inflexibility. Tuition futures plans incur these problems and more. The

participants generally must predict tuition inflation and investment earnings over longer periods.

Tuition futures plans do not guarantee acceptance into or graduation from a college. Most do not cover cost-of-living expenses. (8) Most existing tuition futures plans are those devised by individual colleges. More and more, however, there are proposals and programs for state plans, and there is some discussion of regional and national plans.

Individual Institutions--Approximately ten percent of the respondents to the NACUBO survey have a tuition futures plan in place. (9) Duquesne University (Pennsylvania) has by far the most publicized tuition futures plan. In Duquesne's plan, the amount a family must pay depends on the age of the child--for instance, the amount for 1986-87 is approximately $5,800 for a newborn matriculating in 2004 and $18,400 for a 16-year-old matriculating in 1988. (10)

Paying only $5,800, and even $18,400, may be a bargain when projected tuition for the year 2004 is $93,000 (based on seven-percent annual inflation). (11) But while securing significant savings in Duquesne's plan, families run the risk that the child will not go to Duquesne. The family then receives a refund of only the initial payment, with no appreciation. The plan does offer a restricted transfer option, however: Duquesne will finance a child's education at a different institution with the investment earnings if the child completes one year at Duquesne and maintains good grades throughout college.

The Duquesne plan is limited to 400 enrollees per entering class. The investment instrument is U.S. Treasury zero-coupon bonds. The costs depend on the annual return rate in the bond market and are recalculated each year. The rate of return declined from 11 percent in the first year to 8 percent in the second year; it was therefore necessary to raise the tuition futures rates (by, for instance, $3,000 for a 16-year-old, moving the payment from $15,400 to $18,400). (12)

Despite the risks and the annual fluctuation in cost, the plan has quickly gained in popularity. Originally open in 1985 only to children of alumni, the plan now includes children of non-alumni. So far, the plan has enrolled 600 prospective students, 100 of whom are children of alumni. In fall 1987, the first 18 enrollees in the plan were to have entered Duquesne. Most current enrollees are eight years old or younger. (13)

The Duquesne plan was developed by Fred S. James and Company, an insurance brokerage. At least ten other institutions have signed-up with James and Company to establish tuition futures plans. (14) Duquesne has also received

calls for information from other insurance companies interested in offering their own tuition futures plans. (15) Any institution working with James and Company must agree not to divulge the formulas used, and the company "is not forthcoming about how it develops the pre-paid tuition plans." (16) It's rumored that attrition is a factor in the formulas--that the formulas assume that a number of enrollees will not matriculate, thereby losing investment interest and essentially subsidizing the other enrollees.

Cost schedules are unique from institution to institution. It's reported that in devising a cost schedule, James and Company uses an "actuarially ultra-conservative" financial model with "more than 48 economic and demographic variables, such as the college's projected enrollment and tuition rates." (17) As its payment, James and Company takes a commission of a percentage of the total bonds that are bought. (18)

There are limits to the number of institutions for which James and Company will devise a plan. First, the company will not write a plan for "marginally competitive schools," because there would probably not be sufficient demand for tuition futures at those institutions. Second, the company has agreed that it will not develop plans at two or more institutions close enough to one another to create competition. (19) But as the company continues to sell its product aggressively, the definition of a suitable distance between institutions could get lost in the marketing shuffle. (20)

State Plans--A group of colleges could organize a consortial plan to offer tuition futures that would, because of greater choice, be more marketable than the individual institutional versions. This, however, has not happened, probably because of practical difficulties. Many institutions might not obtain the assurances they seek in group tuition futures plans; that is, any specific enrollment in the plan would not necessarily accrue to a particular institution.

So proposals for group plans instead are occurring as legislative bills. A state plan would cover a set of institutions, usually public, within a given state. Since Michigan developed the first state plan, the Michigan Education Trust, similar proposals have proliferated; several other states have enacted plans as well. According to a recent survey by the Education Commission of the States, "prepayment plans [are] being actively discussed in 20 states and undergoing preliminary reviews in 22 [states]." (21)

The state variant of a group plan runs into some problems that a group plan operated strictly by independent institutions wouldn't. Designers of state plans must wrestle with questions of residency as well as the widely disparate

tuitions among independents and publics and among two-year and four-year institutions.

Regional and National Plans--Some observers feel that state plans, while offering purchasers some choice of institutions, are still too restrictive and that a regional plan (such as a Northeast consortium) could alleviate this problem.

Regional plans could be steps toward a national plan, which would maximize students' choices. The formation of a national plan might also increase the legitimacy of tuition futures as a savings vehicle. Calling the current institutional approaches a fad, one noted researcher asserts that, "the higher education community would be better off advocating and getting enacted a national incentive plan that would encourage parents at every income level to save more for their children's college expenses." (22) A national tuition futures plan might make the tuition guarantee approach more attractive.

There are no formal plans for a nationwide tuition guarantee program. The National Association of Independent Colleges and Universities has discussed a national plan for independent institutions. (23) Appendix one describes a congressional bill--H.R. 2509--which would establish a National Postsecondary Education Trust to administer an advance tuition payment fund.

Some Elements of a State Tuition Futures Plan

This section describes features--participants, relationships, functions--that emerge from a review of legislative proposals for tuition futures plans. Many of the proposals are extremely similar to one another, as most have copied the structure of Michigan's plan. Nevertheless, there is some variation. Various proposals are based on different drafts of Michigan's plan throughout its development; they therefore contain features that have since been modified in Michigan. (24) And proposals in states other than Michigan are undergoing their own evolution. So information cited in the ensuing discussion should not be regarded as the final word from the various states, but more as a list of ideas that have sprung from nationwide discussions of plan designs. (25) Appendix one describes a selection of the proposals reviewed in preparation of this chapter.

The parties that would be involved in any tuition futures plan are the beneficiaries (the students), the investors (or "purchasers," usually parents or

grandparents of prospective students), and the institutions. In a state plan, the plan administrator, or the trust, is an additional, fourth party.

Beneficiaries

The chief points of concern regarding beneficiaries have been residency, transferability, and age.

Residency--A consortium of independent colleges need not worry about residency, but a state plan including public institutions must take into account the difference between in-state and out-of-state tuition. The question is when state residency is registered--at the time of enrollment in the plan or at the time the benefits are used. A plan's viability depends on investment earnings, which in turn depend on the size of the initial payment. Plan administrators would not wish to return funds to beneficiaries who started as nonresidents and immigrated prior to college. And colleges generally would not wish to accept in-state rates for beneficiaries who had become non-residents.

Michigan's standard is based on residency at the date of matriculation (each institution determines its own criteria for in-state/out-of-state tuitions). (26) A beneficiary who moves out-of-state is no longer eligible for in-state tuition rates (and therefore no longer eligible for a full tuition guarantee) no matter how close that person is to entering college or how long the parent has invested in the program.

Other plans would determine residency at the time the contract is signed; (27) an in-state beneficiary would retain in-state status regardless of actual residency at the time of matriculation. This would permit an unconditional tuition guarantee despite the beneficiary's state-to-state migration.

Transferability--The plan would be more attractive to investors if it permitted them to transfer benefits from one beneficiary to another. Transferability would be most attractive to households with more than one child. It would give parents the security of knowing that if the intended beneficiary did not attend college, another child could benefit from their investment. But because tuition guarantees are based on the age of the beneficiary, unconditional transferability is difficult to establish. If benefits were transferred from a 6-year-old child to a 14-year-old, there might not be sufficient investment earnings to cover tuition.

Plans based on Michigan's program give the purchaser the right to rename the beneficiary, on approval of the administering agent. New Jersey's proposed Guaranteed College Tuition Investment Program would specify that if the

investment value was greater than the actual tuition, the purchaser would have the option of either getting a refund or applying the balance to another dependent. A Massachusetts proposal would permit transfer of funds within the immediate family of the beneficiary. Use of funds could be deferred for other family members, but there would be no guarantee of fixed tuition.

Age--The beneficiary's age is important at two points: when enrollment occurs and when the benefits are claimed. Bill language usually specifies that the name and age of the beneficiary must appear in the contract, so the beneficiary would at least need to be already born. In Michigan, efforts are underway to delete this requirement so that corporations can sponsor scholarship programs for unnamed beneficiaries. (28)

Plans modelled on Michigan's program direct that if the beneficiary has reached a specified age (e.g., 16 years, or perhaps a more complicated standard of four years before college entrance), the contract shall be based on the highest tuition rate of the participating institutions or of the specific college the beneficiary plans to attend.

The Michigan model does not set time limits within which the beneficiary must use the benefits, but directs that the contract is to establish time limits. If the benefits are not used within the established time limits, and if the beneficiary or purchaser cannot be located, the contract is terminated and the refund amount is kept by the trust.

Purchasers

Purchasers' residence and relationship to the beneficiary are pertinent in some proposals.

Residency--Residency standards for determining tuition rates are usually applied to beneficiaries, not purchasers. It's probably assumed that the residences of purchasers (usually parents) and beneficiaries (usually their children) would be the same prior to matriculation. A flexible residency requirement for purchasers would increase the attractiveness of the plan, because it would allow anyone (not just parents) to act as a purchaser. It would allow for the occurrences of single-parent households--the other parent, a potential purchaser, might reside in another state. Nevertheless, some state proposals have applied somewhat limiting residency standards to the purchasers.

Unlike plans based on the Michigan Education Trust, which set no residency requirements for the purchaser, New Jersey's proposed Guaranteed College Tuition Investment Program would require that the purchaser be a resident for 12

months prior to enrollment in the plan. The purchaser would then be considered a resident as long as the contract terms were fulfilled. Also, the beneficiary would be considered a resident for the purpose of determining tuition rates.

Some proposals would permit the purchaser to deduct the payment from state taxable income. A purchaser who emigrated would no longer obtain the tax benefit.

Relationship to the Beneficiary--Proposals following Michigan's lead do not specify a particular relationship between investor and beneficiary. Essentially, this means that investors can purchase benefits for themselves, their children, grandchildren, spouses, or other persons. (29) If a person is both purchaser and beneficiary or purchases for another adult, it remains necessary to establish the period over which earnings will accumulate--the time of first use of the benefits would have to be established to ensure that enough interest accrues to cover tuition.

Participating Institutions

Unlike an autonomous institutional plan, a state plan incorporates a number of colleges. These colleges could conceivably be any configuration of public and private institutions and two- and four-year institutions. While a plan structured to include only four-year public institutions would be the simplest to administer, it might harm those institutions not included and restrict the participating students' academic choices. But to include all institutions, with tuitions ranging from that of a junior college to that of an elite university, presents a problematic discrepancy.

Plan design must deal in some way with the degree of heterogeneity in financial needs and educational goals exhibited by an institutional group. Essentially, tuition futures plans contain two agreements:

- that between the families and the trust; and
- that between the institutions and the trust.

Most proposals say little about the institutional/trust relationship and mainly specify rights and responsibilities for families that may constrain the institutions in coming to an agreement. Proposals based on Michigan's plan, for instance, make little reference to the agreement between the institutions and the trust, instead simply directing that the administrative body is to make the necessary arrangements with the institutions to fulfill contract obligations to

purchasers. Missouri's proposed College Tuition Trust Fund Act is slightly more specific, directing the trust to pay an institution within 30 days of receiving written notice that the beneficiary is enrolled in that college and stipulating that the institution is to inform the trust of any scholarship awarded to a beneficiary.

Tuition Discrepancy Among Four-Year Schools--A plan for public colleges only might not need more extensive contractual detail. But inclusion of independent colleges would practically require a much more detailed agreement, because the discrepancies among tuition rates are much greater (and the amount of financial risk therefore higher).

One way for groups to handle tuition fee discrepancy is to jettison the guarantee provision. In the Michigan Education Trust, if a participating student wishes to attend one of Michigan's independent institutions, the tuition prepayment contract is terminated and the refund, which is based on the prevailing average of tuitions at the state's public institutions, is directed to the independent institution. In Indiana's Baccalaureate Education System Trust, a refund that was transferred to an independent institution could not exceed the highest prevailing public tuition. In Missouri's proposed College Tuition Trust Fund, the transferred refund would be based on either the cost of tuition due to the qualified beneficiary or the average state tuition, whichever was less.

A group could use an index. It could sell standard tuition units (STUs), each of which could represent the group's average cost for one credit; each college's tuition would be indexed against this standard cost. (30) A beneficiary's access to institutions would depend on the number of STUs purchased. For instance, the total STUs might be sufficient to guarantee tuition at a community college, but would cover only a portion of the tuition at other institutions. While such an indexed system loses the full guarantee, it accommodates great heterogeneity.

In the Massachusetts proposal for a College Opportunity Investment Fund, families could buy tuition in shares of $1,000; the minimum amount would be one year's tuition at the least expensive participating institution, and the maximum would be four years at the most expensive institution. Participating institutions would provide projections of tuition costs and agree that the projections would be binding. New Jersey's proposed Guaranteed Tuition Investment Program would be based on a similar principle, with annualized tuition projections for 15 years into the future. The guarantee could be used at any parti-

cipating institution the projected tuition of which investors had covered with their payments.

Most proposals are not aggressive attempts to include independent institutions. But for states with substantial independent sectors and pronounced tuition discrepancies, it may be necessary to address this problem before designing the purchase contract. (31) In all likelihood, a plan that would result from this strategy would present more clearly defined relationships among the institutions and between the institutions and the trust than do the existing bills.

Including Two-Year Schools--Some proposals contain directives for transferring benefits from two-year colleges to four-year colleges. Two ways of including two-year institutions are separate agreements and termination of four-year baccalaureate contracts.

In the Florida Prepaid Postsecondary Education Expense Program, community colleges are included through a separate contract. The purchaser can enroll in either a university plan, which guarantees credit hours up to a baccalaureate degree, or a community college plan, which guarantees credit hours up to an associate's degree. A student enrolled in the university plan can convert the credit hours required for an associate's degree to a community college plan and retain the balance of credits in the university plan or request a refund. If students wish to switch from a community college plan to a university plan, they are not guaranteed coverage of the tuition at the more costly school and have to make up the difference.

In the Michigan Education Trust and those plans modelled on it, students may attend two-year colleges. Upon completion of the associate's degree, the student can elect either to terminate the four-year baccalaureate contract, with a refund of the balance going to the individual specified in the contract, or to continue at a four-year public institution at no extra tuition charge to complete the baccalaureate degree. There are variations in other state plans as to the amount of refund given upon completion of the associate's degree and termination of the contract. In the Texas Baccalaureate Education System Trust, the refund would be based on the tuition of a four-year institution charging the lowest rate of tuition. In the Connecticut Higher Education Opportunity Trust, the refund would be 50 percent of the highest tuition cost or 50 percent of the face amount of the payment plus interest.

Administrator

The administrator, or trust, is responsible for operating the plan--contracting with purchasers, collecting funds and reinvesting them, making payments on claims and monitoring solvency. The trust could be a state agency or authority, either newly created (as in Michigan) or already established (e.g., New Jersey's Higher Education Assistance Authority). In proposals modelled on Michigan's plan, the trust is provided with the rights and responsibilities necessary to implement a plan--most of the design decisions are left to the trust.

While the agency designated to administer a state plan might have the necessary resources, it could still be valuable to contract for the performance of certain functions. The agency could contract with private management services to handle collection and investment. Florida's law calls for contracting with:

- a records administrator to conduct the daily operations of the program;
- a trustee services firm, which would act as an investment counselor; and
- authorized insurers, banks and investment companies to provide investment instruments. (32)

Enactments could specify qualified investment instruments, such as high grade corporate bonds, U.S. Treasury obligations, Prime-1 commercial paper, and certificates of deposit. Some proposals would permit plan funds to be pooled for investment purposes with state funds, including pension funds. The specific investment instruments are critical, for tuition futures plans require investment that is both safe and productive of high annual earnings. Such instruments are rare almost by definition.

Most plans would require annual audits and reports to the legislature. The funds themselves could be a separate account in the state treasury and could consist not only of payments from purchasers on behalf of beneficiaries, but also state appropriations. In most proposals, however, assets of the fund would not be considered state money and could not be loaned, transferred or used by the state for any purpose beyond the scope of a prepaid tuition plan. Some plans would not permit assets to be commingled with state funds. If any balance remained at the end of a fiscal year, it would in most cases be carried forward to

the next year, and an additional percentage of the fund could be directed to a contingency subaccount. (33)

Bills based on the Michigan Education Trust list reasons, in the following order, for disbursing monies from the fund:

- to make payments to state institutions of higher education on behalf of qualified beneficiaries;
- to make refunds upon termination of advance tuition payment contracts; and
- to pay the costs of administration and organization of the trust and the fund.

Tuition futures plans are designed to be eventually, if not initially, self-sufficient. It may be necessary at first to cover administrative costs with state funds. Florida projects that $500,000 will be necessary to cover start-up costs. (34) The Michigan trust is planning either to borrow money from the State or from another State agency. (35) Plans modelled on Michigan's require that part of the payments cover administrative costs and that these costs be subtracted from refunds.

Some Other Features of the Purchase Contract

The basic agreement is that in return for a specified payment from the purchaser to the trust, the beneficiary will receive a guarantee of full tuition coverage at one or more of the institutions participating in the plan. In New Jersey's proposed Guaranteed College Tuition Investment Program, purchasers would receive a 10-percent discount on tuition. They would be required to make payments intended to accumulate to 90 percent of projected tuition or 90 percent of actual tuition, whichever was less.

In Michigan's plan, the contract sets forth the rights and obligations of the trust and the purchaser, such as the number of credit hours covered up to a baccalaureate degree, conditions for termination and withdrawal, the time period within which the contract is valid, and payment terms. The legislation specifies that a contract may not be sold or transferred without approval of the trust.

Termination of the contract prior to its full execution could occur for any of several reasons. (36)

- The beneficiary dies;
- the beneficiary's college application is rejected;
- the beneficiary chooses not to attend a participating institution;
- the beneficiary attends a community college and chooses not to continue to a four-year program;
- the beneficiary fails to use the benefits within the specified period of time; or
- the purchaser fails to make sufficient payments.

Refund policies upon termination vary. (37)

- Some proposals would include earned interest as well as principal for most terminations. In Michigan, investors choose a refund option--principal plus interest or without interest--and the particular choice determines other contractual features.
- The refund could be based on tuition costs, whether it is the average tuition cost of the institutions or the lowest tuition cost.
- Refunds could be differentiated by the date of termination. In Connecticut's plan for the Higher Education Opportunity Trust, for instance, a contract terminated before the beneficiary graduated from high school would yield the principal without interest; if the contract was terminated after the beneficiary graduated from high school, the refund would be 50 percent of the highest tuition cost in the plan or 50 percent of the principal plus interest. In Michigan's plan, a student completing more than half of the credit hours required for a baccalaureate degree is not entitled to a refund. This does not apply, however, to those students electing to attend a community college.
- Refunds could be based on whether the student attends an in-state or out-of-state institution. A Connecticut proposal would specify that if the beneficiary attended an out-of-state institution, the refund would be the lesser of 85 percent of the highest tuition cost or 85 percent of the principal plus interest. A New Jersey proposal would offer a full refund of principal plus interest if the student attended an out-of-state school.
- The plan could specify that refund payments be spread out in installments.

The plan could require one lump-sum payment by the purchaser at the time of enrollment or allow a series of smaller payments. Payment through payroll deduction is one possible option. (38) The entry cost could be low, with

subsequent payments gradually increasing. The Michigan Education Trust plans to permit extension of payments over a period of one-to-two years. (39)

While a tuition futures plan is meant to alleviate anxiety about future tuition costs, it nevertheless can cause an immediate financial burden. Very few families actually save for higher education, and most families have limited liquid assets whatever their income levels. (40) Installment plans could relieve some of the burden. Some suggest further assistance: a low-interest loan offered by the state or (for an independent consortial plan) through banks. New Jersey's proposed Guaranteed College Tuition Investment Program would permit the purchaser to borrow from an authority-established fund to make payments. If the beneficiary, upon reaching college age, preferred an institution more expensive than the one covered by the final value of the investment, low-interest loans would be available to cover the additional cost. (41)

The money necessary to make such loans could be borrowed from the state or a public authority. Some even suggest taking it from the tuition futures fund, which in its early years would be accumulating without payouts. The Michigan Education Trust is working on an arrangement with the institutions in which the institutions would provide loans to participants. (42)

There is some irony in these borrowing schemes inasmuch as advocates of tuition futures often bemoan the increasing student indebtedness. Given the possibility that the child may choose not to attend the designated college or set of colleges, parents taking loans for tuition futures could lose the interest earnings on the investment while also paying interest on a loan.

Many state plans offer state tax incentives--deductibility of the payment, exemption of earnings, or both. In Michigan, deductibility is offered if (among other conditions) the contract is signed at least four years before college enrollment. Some plans do not offer any tax incentives: Wyoming's plan makes no mention of tax benefits, but tuition is very low (approximately $300 for in-state, $1,200 for out-of-state), so tax benefits might not be important. (43) New Jersey's proposal doesn't offer tax benefits, but it does offer a tuition discount and loans to help finance payments.

The Central Design Problem: Satisfying Both Parties

This chapter has been about plan structures; it has described the matters that contracts must address. There is variation from state to state in the

way laws and proposals address these matters, and the configurations of structural features do offer such diversity that it's conceivable a plan could satisfy the needs of both institutions and investors. In the next chapter, we will explore the dynamics of the tuition futures idea; we will examine the tradeoffs necessary for a particular plan structure to be both helpful to institutions and marketable to investors.

CHAPTER 3

FITTING IT ALL TOGETHER--
A PROBLEM OF DISTRIBUTING INVESTMENT RISK

In this chapter, we will first review those questions of viability which are inherent to the tuition futures idea and then explore some possible modes of state involvement.

As with any financial instrument--mutual funds, commodities futures, even certificates of deposit--decisions to buy or sell tuition futures call for some prediction. In order to assess the wisdom of offering or buying the product, sellers and investors must predict trends in alternative investments, costs of operating colleges, tuition increases and enrollment. Any decision to buy or sell carries risk, more or less, for investor and seller.

The way the instrument is constructed determines how much risk each party bears and thereby determines whether investors and sellers will come together. If the sellers bear too much risk, they won't offer the product; if the investors bear too much risk, they won't buy. The basic problem of designing a tuition futures plan is to distribute risk such that both sets of parties--institutions and investor-parents--will find it advantageous to contract with each other.

The Participants' Ideal Plans

The Ideal Plan for Institutions

The primary objective of the institutions in a tuition futures plan is to enhance the enrollment base--or more generally, the revenue base--while not taking on too much financial risk. To do this, they wish to use investors' monies freely and over an extended period in order to deal with institutions' central risk--that earnings on the monies they collect will fail to keep pace

with increases in tuition fees (which in good part reflect increases in the institutions' costs of operation). To state it simplistically, if the amount by which tuition fees rise exceeds the amount institutions earn on the families' payments, then the institutions will have lost their bet--they will be liable to educate beneficiaries for whom they have received less revenue than they have determined is necessary to educate a student to the institutions' standards.

To improve the probability that their earnings on investors' payments will be adequate, then, institutions would include these features in their ideal plan:

- The plan would limit withdrawal. The institutions can reasonably expect that the number who eventually matriculate will fall short of the number who enroll in the plan. If a beneficiary for any reason fails to register for college (at all or for less than four years), only the prorated principal would be returned to the investor; earnings would accrue entirely to the institution. (Few seriously suggest that the institution should keep the principal as well if, for instance, a beneficiary decides not to attend college.)

  The institutions, in effect, obtain tuition revenues without having to educate the beneficiary. The beneficiary's spot in the college is perhaps taken by someone who pays full current tuition, and the retained earnings constitute a cushion on which the institutions can depend in those periods during which investment earnings fall short of tuition and cost increases.

- The plan would limit portability. A tuition futures plan operated by a group of institutions would be ideal for the institutions if investors had to specify one college at which the tuition guarantee would be valid. In the extreme and probably only hypothetical case, the colleges would form their consortium only to reduce the administrative overhead (with, for instance, common computer facilities and a single set of accountants), and not to make the plan more marketable by offering beneficiaries a choice of colleges where the guarantee would hold.

  The effect of tying the guarantee to a single institution would be to maximize the parents' risk in predicting which institution the beneficiary will be willing and able to attend. There would be some error, and the advantage of retained earnings upon withdrawal would accrue to the institutions more frequently than it would if the guarantee was valid at many or all of the institutions within the consortium.

  Limiting portability could also protect higher-priced institutions from occasionally having to settle for the revenues receivable at the lower-priced institutions with which they marketed a plan.

- The plan would limit transferability. Prohibiting parent-investors from using benefits for the brother or sister of the named benefi-

ciary would increase the institutions' opportunity to obtain the withdrawal profit. It would also ensure that the period prior to a beneficiary's matriculation (during which the college was accumulating interest on the payment) would not be shortened by transfer of the benefits to an older child.

- The plan would avoid tuition discounts. The institutions would be better off if they could sell tuition futures simply on the basis of the peace of mind it offered parents. Tuition discounts would increase the difference between the sum the investor pays and the actual average tuition fee the institutions need in order to operate at the time the beneficiary attends college. Trying to induce investment through tuition discounts, then, would increase the amount of money the investment earnings would have to make up in order for institutions to operate the plan without losing money.

- The plan would require lump-sum payment. The earlier the institutions obtained all of the investors' money to be provided under the contract, the longer they would have to use it to generate investment earnings.

In just about any kind of tuition futures plan, all parties have some risk. Investors will purchase peace of mind at the risk that the saving in tuition costs will be less than the amount of money they could reasonably have expected to earn through alternative investments. And the quality and value of education from the designated college or set of colleges could decline between the time of investment and the time of graduation.

Under the institutions' ideal plan, the investors would in addition bear virtually all of that risk which is related to prediction of what a beneficiary will actually do when he or she reaches college age. And in those cases in which the beneficiary did do what the investor predicted--i.e., the beneficiary did enroll in and graduate from a designated institution--there would no doubt be many cases in which the student has paid a price: enrollment in the plan would practically, through plan restrictions or family influence, limit the student's choice of institutions.

The Ideal Plan for Families

The primary objective of the families is to obtain peace of mind about the problem of paying rapidly escalating tuition fees, and their ideal plan would permit attainment of this goal without their giving up too much flexibility. The components of an ideal plan from a family's standpoint, then, would require the institutions to bear the portion of risk based on the beneficiary's eventual decision. The plan would have these features:

- Withdrawal would result in no penalty. If the beneficiary for any reason did not attend one of the colleges, the consortium would return both principal and virtually all earned interest to the participating investor.

- The guarantee would be portable. Payment would guarantee coverage of tuition at any institution in the consortium. The larger the group, the more valuable this feature would be.

- Transfer would be permissible. Families with more than one child would be able to transfer the benefits from one child to another. Even less limiting would be plans which permitted investors to transfer the guarantee (perhaps through sale) to anyone.

- Tuition would be discounted.

- There would be payment options. Lump-sum payments could prove too large for many families, forcing them to resort to loans. Having the option of smaller, installment payments over a longer period of time would be to a family's advantage.

In a tuition futures plan involving a guarantee, the fundamental risk that the institutions can never avoid is the risk of interest on parents' payments failing to cover the tuition increases that occur between the time of payment and the time of matriculation. Institutions improve the probability that they won't operate the plan at a loss if they obtain investors' entire payments immediately upon enrollment in the plan and retain all of the earnings when beneficiaries don't matriculate at the institutions. And assuming full enrollment at the colleges, the more such withdrawals, the better.

The families' ideal plan would deny the institutions this margin; it would increase the degree of consistency with which institutions would have to obtain investment earnings equal to or greater than tuition increases.

Finding a Balance

If we continue to confine our focus to the direct participants, we can describe the problem of viability and advisability with some simplicity. Can institutions and investors negotiate a distribution of risk--a balance--such that substantial numbers of both institutions and parents will be willing to contract with each other? The features of the plans do offer opportunities for varying distributions of risk, but the tuition futures idea is so young that we don't yet have evidence that such a balance is possible over a long period of time.

Institutions can, by restricting plan enrollment, reduce their risk without requiring investors to assume more risk. If a plan is kept small,

institutions can absorb the losses arising from faulty projections without serious effect on their operations. A small plan, however, means small potential benefits.

Much depends on the number of people whose need for peace of mind about tuition affordability might be characterized as great or even extreme. The larger that number is, the more institutions can successfully offer tuition futures that tilt toward the institutions' ideal. But in a world in which people manage their money with increasing awareness, it's only realistic to think that some negotiation will be necessary in order to move from two different ideal plans to a workable plan. This negotiation will probably occur indirectly, as institutions modify plans upon ascertaining their salability. If the number of respondents is great, institutions may be able to sell plans that shift more risk to the investors; if the number of respondents is small, plan administrators will understand that investors won't spend their money on tuition futures unless institutions absorb more risk.

The choice of colleges that group institutional arrangements can offer to beneficiaries will certainly enhance salability. Nevertheless, there will no doubt be variation from group to group in the configurations of withdrawal, portability, transferability, discount and financing features. For instance: Institutions could offer discounts to induce investment in plans with strict withdrawal penalties. Easy transferability could make it easier for parents to justify investment in a plan with low portability. Installment financing might make lack of a discount acceptable.

Although the administrative complexities might deter many institutions, a consortium could design a plan that offered more than one configuration of features. For instance, investors could choose either discounted tuition with a severe withdrawal penalty or full tuition with little withdrawal penalty; tuition discounts could be more or less time-restricted; installment plans could require equal payments or a larger initial payment; withdrawal penalties could vary on the basis of the reason for withdrawal. In all, the objective would be to find configurations that could serve the needs of institutions and investors simultaneously.

New Jersey's proposed Guaranteed Tuition Investment Program, for example, would have offered no tax benefits and would have limited transfer to immediate family members, but it would have offered a tuition discount, loans, and portability of benefits between public and independent colleges. (1) Michigan's plan has strict residency requirements and limits transfer, but it offers tax

benefits. Wyoming's plan offers no tax benefits and limits transfer, but it provides for coverage of room and board expenses.

Some Complications

Actual plan design involves more than simple bargaining between institutions and investors; there are complicating tasks:

- arrangements among institutions that form consortia to offer the plans; and
- taxation.

Tuition Variation Within Institutional Groups

The Central Problem: the Guarantee--Tuition futures plans have several elements which can be "negotiated," but their central element is the guarantee. It's chiefly the tuition guarantee that offers the investors the peace of mind that motivates most of them, and it's the tuition guarantee that creates the risk that the institutions bear. The other discussed features of the plans can be seen as limits on the guarantee; an unconditional guarantee would be unlikely to make fiscal sense for the institutions.

But even apart from the question of whether investment earnings will keep up with tuition increases, guaranteeing tuition creates a serious technical problem in group institutional plans. The institutions are likely to have different tuitions, and projections of tuition at each institution will commensurately differ. The amount which a tuition futures investor is required to pay, however, is based on a single projected tuition fee. Therefore, in a consortium of institutions with various tuition fees, an investor paying an amount in the middle of the range of tuition fees could well be conveying to the consortium an amount that will be:

- too low for higher-priced institutions to avoid loss if the beneficiary selects and is admitted by one of them; and
- too high for the investor to avoid an earnings loss if the beneficiary attends a lower-priced institution.

Designing Portability--One approach to this problem would be to make the guarantee completely portable and to treat the matter as simply another risk:

The consortium would project an average tuition fee and then specify an amount required from the investor. If the beneficiary attended a higher-priced institution, the investor would have won the bet and the institution would have lost; if the beneficiary attended a lower-priced institution, the result would be the opposite. From the standpoint of the plan's overall fiscal viability, the aggregate results might "wash out": each institution would win some and lose some, but the group would have enhanced enrollment without incurring a net lost. In reality, however, investors would be quite aware of the greater value of the beneficiary's attendance at a higher-priced institution, and the higher-priced institutions would probably receive a disproportionately high percentage of the beneficiaries' applications.

Another approach would be to make the guarantee completely unportable; it would be applicable to only one institution within the group, and the amount paid by the investor would be determined by the tuition level at the designated college. The group structure would have only an administrative function, and the nature of the withdrawal agreement would be of critical importance. (Investors would be disappointed if the beneficiary, by choosing the "wrong" institution, failed to use the guarantee, but they might not feel stung if the beneficiary was willing and able to use the principal and interest earnings at another of the group's institutions.) A plan with such drastic limitation on portability, however, might not be sufficiently salable.

There emerges, then, the problem of designing the plan to accommodate some portability among institutions with varying tuition levels. Here, for instance, are some possible compromises.

- Targetted Institution--Parents could specify a target institution with the understanding that it could either cost more or less to guarantee tuition at that institution than elsewhere. If the tuition fee at the institution actually selected by the beneficiary was less than that at the targetted institution, the guarantee would hold. The plan's provisions would have to specify which party--the targetted institution or the investor--would have the right to any unspent "balance." (This would be the standard withdrawal problem: institutions might regard their retention of this balance to be necessary for plan viability; investors might regard the possible loss of the balance as too much risk. For those investors who have high regard for all institutions in a group, the tuition guarantee might seem a bargain regardless of the way the balance was handled.)

  If the tuition fee at the institution the beneficiary attended was more than that at the targetted institution, the student would have liability. But there are alternative ways (ways which differ greatly

in the apportionment of risk) of handling this circumstance. For instance:

  - The student could be held liable for the amount by which payable tuition exceeded the guaranteed amount. The guarantee, for instance, could be for 110 percent of the payable tuition at the targetted institution; if tuition at the institution where the student matriculated turned out to be 120 percent of the tuition at the targetted institution, the student would pay the ten point difference between the maximum guaranteed amount and the payable tuition.

  - The guarantee could be voided. In effect, the investor would receive whatever refund accrued upon withdrawal, and the student would be liable for the entire payable tuition. In most cases, it can be expected, the investor would apply the refund toward payment of tuition.

- Targetted Range--The consortium could establish a tier system of institutions based on tuition levels, and families could target their investments to a particular tier. The amount an investor paid could be based on the average tuition at the schools composing the tier. The guarantee would be portable to all institutions within a tier. Lower discrepancy in tuition levels of institutions within tiers would limit the institutions' loss when the group ended up selling a high-priced education for a lower price.

The technical problem for the participating institutions is seen most clearly in the second of the compromises. How big a difference in tuition levels will a higher-priced institution tolerate among members of its tier? The bigger the difference, and the greater the number of institutions with lower tuition, the greater is the fiscal jeopardy in which the higher-priced institution places itself. It seems reasonable to expect that many college fiscal officers would oppose any linkage of their costs with the revenues receivable at lower-priced institutions.

The more homogeneity a group's tuition fees exhibit, the less risk will a guarantee place on the participating institutions. Guarantee agreements would be easier to obtain, then, among public institutions where tuition fees are maintained in uniformity, or close to it, by the state. Independent colleges, in forming a consortium, would have more difficulty arriving at such agreements because their tuition fees have greater variance. And any agreement they did derive would be more likely to exhibit the complicated safeguards contained in the targetted institution and targetted range approaches. Probably most complicated would be a group combining public and private tuition levels.

When we opened this chapter by describing ideal plans, we were speaking of ideal plans that involved tuition guarantees. Even better for institutions would be plans which involved no guarantees. Parents would, 10 to 15 years in advance, deposit with institutions amounts of money which would be applicable toward college costs and which would collect interest, but the tuition payable by the beneficiary at the time of matriculation would be the tuition payable by all students at that time.

Such a plan would erase the institutions' projection risks, and it would make group arrangements easy to administer; portability would never require an institution to offer a high-priced education at a greater bargain than it offers generally. It would make it easy to use a voucher system based on standard tuition units (STUs) to accommodate a broad range of tuition levels. (2) In such a system, the family would purchase a number of STUs based on the average tuition cost at the institutions in the consortium. At the time of matriculation, families would have to make up the difference if tuition at the selected college cost more than the number of STUs purchased, or they might receive a refund if tuition cost less than the number of STUs purchased.

The guarantee, however, is the feature that is most attractive to investors. It's attractive in large part because of the recent high inflation in tuition fees; people are frightened by news stories of possible six-figure tuitions in coming decades. But the success of a "futures" plan that did not involve a guarantee would depend on a degree of alarm among parents that is probably not realistic to expect. Investors could save money toward higher education through many alternative investments, and they could do it without losing access to the money. No doubt there are some parents who are so concerned about paying for college that they begin saving for it many years in advance. But there probably aren't many parents who simultaneously have the means to save significant amounts and are so doubtful of their investment acumen and discipline that they feel a need to commit those amounts, without a tuition guarantee, to a particular college or set of colleges well before their children's wishes and abilities are clear.

The Taxation Dilemma

The prospect of federal taxation of tuition futures benefits looms as an imposing uncertainty. State taxation is both far less imposing and far less uncertain: Legislatures can choose to exempt earnings and even to permit deduction of payments, and they can place varying degrees of constraint on access to

exemption and deduction (the Michigan law lists detailed provisions applying to state tax deduction).

Many think that federal taxation could undermine the marketability of tuition futures plans: "These programs will simply not be attractive to parents if either . . . the interest return is taxed each year or . . . the [final] 'gain' . . . is subject to federal income tax." (3) If a plan is deemed a "savings" or "investment" plan, it would most likely be taxable. If the plan is a "prepayment" plan, it could be "considered a sale of services for future delivery at the time of the initial purchase [with] no gain at maturity and no tax upon surrender." (4) Taxability and inflexibility each could render a plan unsalable, and the more flexible are a plan's provisions, the greater is the risk of taxation; the IRS would consider earned appreciation to be capital gain. (5)

Michigan's plan offers different withdrawal options, Plan A and Plan B, with Plan B allowing withdrawal of interest as well as principal. But some observers think that withdrawal of cash, even if limited to the principal, could cause a tax burden for all participating families, whether they withdraw or not. They could be subject "(1) to annual tax on the implicit interest earned through the plan even though they did not actually receive the interest or (2) tax on implicit gain under the tuition contract [through] the constructive receipt doctrine (you could have had the cash but did not take it)." (6)

The practical problem for plan designers is to ascertain how flexible a plan can be before it becomes subject to taxation. At this time--prior to clear definition by the IRS--the balancing point between flexibility and taxation must be regarded as precarious. It may be that several kinds of limits on flexibility, singly or in combination, might prevent earnings from being taxed. Limits on withdrawal of interest, on portability of the guarantee, and on transferability (limits, incidentally, that would render the plans more like the institutions' ideal) come quickly to mind. Perhaps less drastic limits would be adequate.

- Secondary Market Withdrawal--Perhaps the IRS would be satisfied if those investors whose beneficiaries did not use the benefits had to sell their "shares" in the plan to a secondary market association similar to those that exist in the home mortgage market (i.e., the Federal National Mortgage Association and the Government National Mortgage Association) and pay a tax on the gain. (7) This kind of withdrawal provision, however, would be unlikely to be acceptable to the institutions unless provision could be made for some institutional retention of earnings.

- Time Limits--Specifying a limit on the amount of time during which the guarantee would be valid might make a plan appear to be more like a purchase and less like a savings plan.

- Tax-free Investments--Institutions' investment of the paid sums in tax-exempt bonds might also induce a favorable IRS ruling. (8) Such investments, however, usually carry a low interest rate; gains probably would not keep pace if tuition continued to rise as fast as it has recently. A slowdown in tuition fee inflation would make this possibility more useful.

In Michigan's plan, no contract can be entered into before the IRS issues a favorable ruling. However, there seems to be interest in these plans despite the prospect of taxation. Here, for instance, is a statement by the California Student Aid Commission:

> It is important to note that parents do not invest in these programs because they are lucrative investment options. They are not engaging in speculation, they are providing themselves and their children with security against future increases in tuition and fees at colleges and universities. (9)

But most states considering plans await the Michigan verdict. (Ultimately, even a favorable ruling may be insufficient--as investors in Individual Retirement Accounts know, government officials can change their minds.)

Enter the State?

Current proposals for tuition futures plans, other than plans for single institutions, would involve state governments. Because many colleges are state institutions, some degree of state involvement would be necessary for a plan to include public colleges--the state would have to permit their participation. This would be somewhat more complicated than it may at first appear: If the state authorized public colleges to become involved in tuition futures plans, it would be authorizing them to engage in the projections; if the projections were faulty, the colleges would have to cover losses with current or future revenues. The current and future revenues at public colleges are matters on which the state directly and indirectly decides and provides, so the state might have an obligation to third parties--taxpayers and nonparticipating students--to take an interest in the plan's projections and procedures, even if the intention was simply to permit the participation of public colleges.

The proposals, however, call for the state to create a plan and in some way operate it. Why do proposers choose a "make it work" role for the state rather than a "let it happen" role? Perhaps they think the protection of third party interests requires the state to have such seminal and central involvement. Statements accompanying the proposals, however, focus on the problem of financing college education and imply that tuition futures should be an important part of the solution. Some advocates predict that a tuition futures plan, by inducing saving by some families, would free student aid for use by students who otherwise would receive less aid, or perhaps no aid at all.

But however powerful the tuition futures idea may be for such purposes, the fact is that group institutional tuition futures plans have not emerged from the colleges, even among the independent institutions (which do not need state authorization). Underlying the proposals for state involvement, then, may be some skepticism:

- skepticism that investor-families and colleges can arrive at an apportionment of risk that is agreeable to both; and
- skepticism that expensive colleges and inexpensive colleges can agree on the technical arrangements necessary for them to offer a tuition guarantee cooperatively.

If such skepticism is well-founded (and institutional response to the idea so far suggests that it is), then in order for tuition futures to become a significant part of college financing--that is, in order for a plan to get big--some participant other than the investors and colleges might have to absorb enough risk so that the plan would offer a more daring guarantee than cooperating colleges would offer on their own. In short, proposals for <u>state</u> tuition futures plans may derive in part from an expectation that tuition futures plans won't work unless the state, by absorbing some of the risk, offers itself as a bridge between investors and institutions.

State involvement greatly complicates the tuition futures idea. All the points of design reviewed earlier in this chapter remain pertinent: It would still be necessary to make decisions about conditions on withdrawal, portability and transferability. Designers would still have to decide whether discounts were necessary and feasible and whether the plan could survive if investors were permitted to pay in installments. And there would be a continuing technical problem of accommodating the higher revenue needs of high-tuition institutions within guarantee arrangements that linked them with lower-tuition institutions. State

involvement would also bring up the problem of residency requirements in determining in-state and out-of-state tuition.

The more risk the state absorbed, the easier it would be to design a workable plan. It's not certain, however, that state involvement short of wholesale subsidy would permit design of a plan that would draw great numbers of investors: While people exhibit interest in the tuition futures idea, their responsiveness as investors to a workable plan (one that deviates from the investors' ideal) remains unclear.

This questionable feasibility has so far referred only to the internal working of the plan. But internal workability is an inappropriately limited criterion for state involvement; the state must also consider the broad policy effectiveness of its involvement: Can such a plan be fair not only to the institutions and investors (on whose needs a private plan could focus exclusively), but also to nonparticipating students and taxpayers? How would a tuition futures plan serve the general objectives of access and choice, which have through the decades guided, more or less, the state's decisions on higher educational financing and assistance? Is this the best way for the state to further invest its finite resources in order to maintain and improve access to higher education?

Modes of State Involvement

There are choices available in the mode and extent of government involvement in a state tuition futures plan, and any particular choice will do much to determine how big a plan can get. Generally, the greater the state's involvement, the larger the plan can grow and the more impact it therefore can have on the achievement or frustration of higher educational policy.

It's true that the state could coordinate a tuition futures plan that remained small. It's often claimed, for instance, that the PASS Plan, a defunct New York State tax incentive for college saving, produced little, but the Plan was innocuous enough to permit its continuation (its repeal was incidental to an act adjusting the State's tax code to federal tax amendments). A tuition futures plan that directly or indirectly restricted participation to a small percentage of students likewise would have little practical relevance to higher educational policy: there would be little to fear, and the advancement of state purposes would be minimal. There are a few college administrators and investors--those who are most anxious about the future of tuition fees--who, even without the

state's involvement, can agree on the conditions of a plan. And even if it was necessary for the state to absorb a great proportion of risk in order to make a small plan feasible, this risk would be small in the context of the state's budget or higher educational enterprise.

But those who propose state plans do not seem to be suggesting that the plans should play minimal or negligible roles in higher educational finance. And as the enrollment in a plan grows bigger, so also grows the risk for which the state's participation is needed. The risk grows in two ways: One way has to do with simple weight of numbers. If projections were ever seriously faulty and revenues were therefore insufficient to meet beneficiaries' claims, a plan with many beneficiaries would claim more of the state's resources than would a small plan.

The potential claim of a larger plan on the state's resources, however, would not be larger simply because of the fact of more claimants. Rather, the percentage of potential total losses that the institutions would be willing to bear would decline as the number of enrollees increased. And the more a plan approached the investors' ideal, the more pronounced this institutional risk aversion would be. Many colleges have fragile budgets. A small plan in which projections "went bad" could produce a net loss, but not one sufficient to cause fundamental damage to a college's budget. The same faulty projection in a plan in which the plan enrollees constituted a large proportion of the total number of students could cause a disastrous loss. In an arrangement in which colleges and the state shared the loss burden, then, the colleges would wish their percentage share of the losses to be smaller as the number of plan enrollees grew larger, in effect limiting their absolute losses to amounts approximating those in a smaller plan. Their justification for such risk aversion would be the practical limits on their own budgets; the justification for shifting a larger percentage share of the burden to the state would be the much greater size of the state's budget.

Several abstract categories of state participation in a tuition futures plan suggest lesser or greater involvement; and within some of these categories, there is opportunity for some variation. (10)

Operational Oversight

The state could regulate the plan much as it regulates insurance companies. The state could, for instance, set standards for operating procedures and assets-to-liabilities ratios, audit the plan to monitor its adherence to

standards, and periodically assess the adequacy of the standards. Excess payouts resulting from faulty projections would be covered either by institutional revenues or by higher charges for future plan participants; the state would bear no direct liability for any part of a shortfall. (It could be self-defeating to cover faulty projections by requiring future participants to pay more--higher charges would reduce the marketability of the plan. If the institutions permitted a succession of deficits to drive up the cost of enrollment, it might reduce the pool of participants so much that the plan would no longer attract revenue sufficient to cover the shortfalls.)

But assuming this kind of involvement is simplistic: If the state permitted public institutions to participate, shortfalls which institutions had to cover would practically be the state's responsibility. The state would have to either convey more institutional aid to a participating public college or permit the college to charge higher tuitions.

Nevertheless, this kind of state involvement is possible. It may be that the state's oversight would keep the plan solvent not only by ensuring sound practice, but also by providing the appearance of security on which public confidence, necessary for salability, would be based.

Limited Operation

The state might further increase a plan's legitimacy by operating it. The state would not only set standards and conduct audits; it would also design and modify the plan, set prices, receive payments, invest revenues and process benefits. The state conceivably could do all this without incurring an explicit liability. Its role would essentially be that of a fiduciary, a role the state already plays (for instance, it administers commodity marketing orders and security funds and manages pension funds). The increased liability, compared to that in a simple oversight role, would be that which fiduciaries carry for misfeasance.

Absorption of Residual Liability-- Questions of Contingency and Limits

Simple oversight and operation do not suggest the kind of state role that would most stimulate many investors to buy tuition futures. It's in the absorption of some of the institutions' liability that the state could most encourage such investment.

There are different ways by which the state could absorb some liability. The state, in assuming some responsibility for the solvency of the trust fund, could oblige itself to a simple, annual appropriation. The appropriation could be a fixed amount or it could be indexed (for instance, to tuition cost, the size of the plan, or a measurement of institutions' liability). The state's advantage in this approach would be that its commitment would be limited and relatively predictable. But state infusions should be unnecessary. This stream of public monies presumably would be regarded as a fiscal cushion which would provide institutions with the security necessary to design and market a more daring and therefore more salable plan.

Instead of periodically infusing a plan with money, the state could make its liability contingent on shortfalls. Least complicated would be complete state liability for shortfalls: If fund income for a particular cohort of beneficiaries had failed to keep pace with tuition increases, the state would convey the appropriate differences to the participating institutions. This kind of state absorption of risk would no doubt induce the institutions to be somewhat daring in plan design and marketing.

More realistic would be state infusions that are both contingent and limited. It's important to note here that most proposals do not call for direct state participation. Instead, they create an entity--for instance, a "trust" or a public authority--which is to administer the plan. Among the entity's duties is the development of reserve funds to cover deficits occurring when investment earnings lag behind tuition increases. It's rare that proposers explicitly suggest any state liability; on the contrary, they suggest by reference to reserve funds (and by statements that the plan's monies shall not be considered state monies) that the taxpayers won't be liable. And when they specify a contingent and limited liability from which the participating institutions are relieved, they indicate that it's the administrative entity (and not the "state") which will assume that residual liability through use of the reserve funds. (One significant exception is Florida's enacted Prepaid Postsecondary Education Expense Program, which requires appropriations to cover shortfalls.)

A New Jersey proposal provides a good example. (11) The legislature would establish a public authority to administer a Tuition Assurance Plan Fund. A loan from an existing higher educational assistance entity would enable the authority to establish reserves and cover its start-up administrative costs. The authority would receive payments from investors and reinvest the monies. The

authority would guarantee the participating institutions at least 90 percent of the tuition revenue due from plan beneficiaries. If a shortfall was less than 10 percent of the amount due, the institutions would have to absorb the loss. (If the Fund generated a surplus, the State and the institutions would divide the excess.)

The question of "state" liability is avoided if we assume that the authority's reserves will always be adequate to cover the authority's portion of shortfalls. With reasonably careful management, this should rarely be in doubt. But as usual, things are not that simple. One problem is that "reasonably careful management" can mean restriction of enrollment in the plan--if tuition fees became too volatile, the danger of excessive liability would increase, and maintaining solvency would require minimization of future liabilities. If the point of state involvement is growth of the plan, this would obviously be at odds with policy.

Another problem is the seemingly banal fact that nothing is certain. However banal, this fact is one which New York State painfully confirmed in the 1970s, when several public authorities were unable to meet their obligations. The state was not legally liable to save these authorities from default, but both ethics and the protection of the State's credit practically required the Legislature to appropriate funds, year after year, to cover liabilities for which authority managers had not adequately planned.

So from the standpoints both of policy fulfullment and fiscal uncertainty, assuming away the matter of state liability through use of public authorities is somewhat artificial.

Supplementation

Another possible mode of state involvement is best regarded as supplemental; the state could engage in it with or without any particular kind of participation in the administration of the plan. The state could provide means of reconciling the need of institutions to receive payments in lump sums with the need of many investors to pay in installments. A variation on this idea would be for the state to lend to beneficiaries or parents the extra funds they may need when beneficiaries select institutions costing more than those to which their guarantees apply.

In New York State, the Dormitory Authority already operates a similar program. The Authority's Supplemental Higher Education Loan Financing Program (SHELF) covers, at several institutions, the gap between tuition costs and the

amount of aid a student receives. Repayment occurs over a period of up to 15 years at interest ranging from 11.7 percent to 13.87 percent. (12) An authority could fund such a program for a tuition futures plan through bond issues, with a charge levied on participating institutions and families to cover operating expenses.

The irony in this kind of supplementation is that tuition futures are touted as a means of reducing the extent to which college financing depends on borrowing.

Toward a Real-World Look

This chapter has explored the dynamics of tuition futures plans in general and as state participation would affect them. Looking at state tuition futures plans in the abstract, however, is inadequate, at least in the case of New York State. New York is one of the states in which the independent sector is large; in fact, about half of the college students in New York State enroll at independent colleges. So tuition variation here is far greater than in most other states; a workable tuition futures plan, therefore, would be even harder to design than it appears to be in the abstract.

That reality and an alternative are the subjects of chapter 4.

CHAPTER 4

A BETTER DISTRIBUTION OF THE BURDEN

We have seen that designing a guarantee plan that offers much choice and portability would be far easier in places where there is little variation among the colleges' tuition fees. State governments manage public colleges' tuitions--they control tuition fee increases by giving institutional aid, and they directly regulate school-to-school variation in tuition fees. The places in which there is likely to be great variation in tuition fees, therefore, are those places in which many of the colleges are not public and must deal with their costs without major streams of state institutional assistance.

A Problem of Effectiveness

The Importance of the Independents

In seven states, entirely clustered in the Northeast and including New York, the independent sector enrolls more than 30 percent of the students attending college in those states (see table 6). In fact, the eighth-place state in this respect (Missouri, at 28.6 percent) falls a full nine points behind the seventh-place state (Maine, at 37.7 percent).

Of those New York State full-time undergraduates who are New York State residents when they enroll, about one-third attend independent colleges. And of the full-time undergraduate enrollment in New York's independent sector, more than 70 percent is composed of New York State residents. (See table 7.)

Enrollment in the independent sector among all college students in the United States is 22.3 percent, and it's probably no mere coincidence that the first statewide tuition futures plan was established in a state with independent sector enrollment well below the national average (Michigan, at 14 percent). (1)

Table 6

Percent of Students Enrolled in the Independent Sector

Top Eight States Fall 1983

Massachusetts	56.0
New Hampshire	50.9
Rhode Island	49.2
Pennsylvania	43.7
New York	43.3
Vermont	41.9
Maine	37.7
Missouri	28.6
United States	22.3

Source: Figures derived from raw numbers contained in United States Department of Education, Office of Educational Research and Improvement, Digest of Education Statistics, 1985-86, Table 77, p. 90.

Note: These percentages include part-time students. State Education Department numbers indicate that the independent sector share of full-time enrollment in New York somewhat exceeds 50 percent. (New York State Education Department, Office of Policy Analysis, New York State Enrollment Trend Tables, May 1986.)

Table 7

New York State Resident Students and Sectors

Full-Time Undergraduates (UG) from New York State, 1985

	Number of Students	% of Sector Enrollment	% of All Resident UG Enrollment
SUNY	201,176	96.0	42.4
CUNY	93,862	95.4	19.8
Independent	158,861	72.4	33.5
Proprietary	20,367	91.4	4.3
	474,266		100.0

Source: Extracted and adapted from figures supplied by the New York State Education Department, Bureau of Postsecondary Research and Information Systems, July 2, 1987.

The significant role of independent colleges in New York State is not a simple matter of current students' matriculation preferences. Two hundred years ago, independent colleges provided the only higher education available in the state; the independents' longer history has meant that New York's most prestigious colleges and largest academic research facilities are in the independent sector. Because of this inheritance, New York State, in contrast to almost all of the younger states, was able to defer the development of a large public system of higher education. The State's program of Bundy aid is an acknowledgement of the contribution the independent sector makes to the commonweal.

So the importance of the independent sector is a clear and even cultivated fact of higher education in New York State. This makes a tuition futures plan harder to design here than in Michigan.

- In New York, there are more colleges at which tuition is a major revenue source, and in an atmosphere of rising operation costs, administrators at those colleges must be generally wary of putting any limits (including a guarantee) on that revenue source.

- This general wariness of limits on tuition increases would exist even with regard to plans in which the guarantee had very little portability. But the great variation in tuition fees--a variation which cannot be avoided by excluding only a few colleges from a plan--does make it less likely that institutions can come to agreements tying high-tuition colleges to revenues received at lower-tuition colleges.

- The amount of risk the state would have to absorb in order to make a plan with much portability work would be far greater than in Michigan, where the State controls the tuitions of the great majority of students and institutions.

The State could avoid these problems by creating a tuition futures plan that excluded the independents. This would make it more difficult for the independents to compete for students. The independents might respond with their own tuition guarantee arrangement, but they would be hard-pressed to offer as much portability because of tuition variation.

What's the Cost Problem, Anyway?

Creating a tuition futures plan that excluded the independents, in fact, would seem to be an essentially faulty tactic in dealing with the problem of college costs: By excluding the independents, it would fail to attend to the instances in which tuition is the most significant burden. And in treating tuition at public colleges, it would be attending to the part of public college

costs which is the minor burden. Table 8 provides some helpful figures: Tuition and fees at the State University campuses over the past five years have held at about one-fourth of the total cost of tuition, room and board; it's the room and board costs that constitute the major share. (SUNY's 1985 Dormitory Self-Sufficiency initiative, as the State continues a low-tuition policy, may even drive-up the proportion of costs constituted by room and board.)

It's at the independent colleges that tuition is the major and increasing burden: The percentage of costs attributable to tuition rose from 56.1 in 1980-81 to 60.2 in 1986-87; the percentage constituted by room and board declined, from 43.9 to 39.8. Any continued inflation of tuition at a rate higher than that of the Consumer Price Index can be expected to further increase the percentage constituted by tuition.

A plan that dealt with the major college costs, then, would be one that managed tuition fees at the independent colleges and room and board fees at the public colleges. Including room and board would certainly complicate the problems of predicting costs and developing refund guidelines for withdrawal. Room and board expenses vary not only from college to college, but also among students at the same college--some live on-campus, where costs are reasonably predictable, and others live off-campus by themselves or with their families.

Also, earnings in a plan that covered room and board would be more likely to be taxed by the federal government: Payments into a program covering costs that vary not only from college to college, but also from student to stu-

Table 8

Tuition vis-a-vis Room and Board
Dollar Amounts and Percentage of Total Costs

	Tuition & Fees		Room & Board	
	SUNY	Indeps	SUNY	Indeps
1980-81	1003 (24.7)	4159 (56.1)	3063 (75.3)	3252 (43.9)
1986-87	1483 (24.7)	7347 (60.2)	4511 (75.3)	4850 (39.8)

Source: Extracted and adapted from figures furnished by the New York State Education Department, Office of Postsecondary Policy Analysis, April 22, 1987.

dent, might seem more like savings than simple prepayments. Also, the federal tax code, as most recently amended, specifies that portions of scholarships and fellowships covering costs other than tuition and certain fees are taxable. (2)

Who Needs It?

If the independent institutions are the places where tuition futures plans are needed, an observer might reasonably ask why the State should create a plan. If administrators at the independent colleges found that a group tuition futures plan would help them to deal with the competitive disadvantage of their high and rising tuitions, they could form a consortium, develop a plan and market it; they do not need the State's authorization.

The independent colleges, in fact, are leery about government-sponsored tuition futures plans. Here is a recent statement by the Task Force on Tuition Prepayment Plans of the National Association of Independent Colleges and Universities:

> The Task Force believes that any nationwide tuition prepayment plan which might be organized for independent colleges and universities should have a national charter and be formed as a non-profit membership organization rather than a federal or state authority. Such an entity with principal governing authority vested in member institutions would have several advantages over a government-controlled organization:
>
> - It could be formed without state or federal enabling legislation.
> - It would facilitate portability of tuition services at maturity.
> - It would be unencumbered by public personnel and contracting restrictions.
> - It would be more responsive to the concerns of participating institutions. (3)

Many administrators at independent colleges are understandably reluctant to link their revenue needs, which they must satisfy in great part with tuition fee income, with other institutions' lower tuition fees. And while there is always the possibility that a particular increase in tuition fees will prove to be the one that results in serious enrollment declines, the current evidence does not suggest that the independent colleges, as a group, are in great trouble.

Tables 9-13 offer some enrollment measurements. Between 1980 and 1985, enrollment declined at SUNY and CUNY (by 3.4 and 12.8 percent, respectively) while enrollment at the independents slightly increased (by 2.2 percent). The independents' share of full-time enrollment increased between 1980 and 1985 from 52.0 percent to 53.5 percent.

The Regents' 1984 enrollment projections, however, are not comforting: their most recent published figures have enrollment at both SUNY and the independents declining by more than 20 percent between 1983 and 1992. (Each sector's projection for itself was far more optimistic: -0.9 for SUNY, +0.1 for the independents.) Projected declines in the number of New Yorkers aged 15-19 and 20-24 (declines of 24 percent and 13 percent, respectively) over roughly the same period provide much of the basis for the Regents' enrollment projections.

It may be that independents' recent increases in their own institutional aid to students has permitted them to maintain enrollment numbers and that increasing costs of operation will undermine their ability to continue such an aggressive aid strategy. In that case, further large tuition increases could bring declines in enrollment (though recent history suggests otherwise for the elite schools). Nevertheless, in the current situation of reasonably static (and even positive) enrollment trends, the independents are understandably not jumping at arrangements which could threaten one of their major revenue sources.

A Problem of Fairness

Access, Choice, and Subsidies

We have suggested that the simple feasibility and cost-effectiveness of the tuition futures idea in New York State is questionable. New York State has a particularly large independent sector, which makes tuition variation a significant impediment in the design of a plan. And excluding the independents makes little sense inasmuch as they are the institutions where tuition is a major part of the problem of college costs; at the public colleges, room and board is the major part.

But when government sponsorship of an effort is proposed and considered, simple feasibility and effectiveness are not the only criteria. Government programs should not only be effective; they should also serve the State's policy purposes, and they should be fair. Tuition futures plans suggest questions of

Table 9

Trends in Fall Enrollments
Percent Change

	1975-85	1980-85	1983-84	1984-85
SUNY	-3.2	-3.4	-1.2	-2.0
CUNY Senior	-36.6	-12.8	-4.9	-1.9
Independents	16.3	2.2	-1.3	1.5
Proprietary	86.7	25.0	-0.5	-7.1

Source: Extracted and adapted from New York State Education Department, Office of Postsecondary Policy Analysis, New York State Enrollment Trend Tables, April 1986.

Table 10

Sector Shares
Percent of
Full-Time Enrollment

	1975	1980	1983	1984	1985
SUNY	28.6	28.9	29.1	30.2	29.7
CUNY	25.3	18.5	17.0	16.6	16.2
Independents	45.6	52.0	53.2	52.6	53.5
Proprietary	0.5	0.6	0.7	0.6	0.6

Source: Extracted and adapted from New York State Education Department, Office of Postsecondary Policy Analysis, New York State Enrollment Trend Tables, April 1986.

Table 11

Comparison of Enrollment Projections Prepared by Each Sector with Regents' Projections

	Percent Change Projected between 1983 and 1992	
	Sector	Regents
Full-Time Undergraduate		
SUNY State-Operated	-0.9	-24.2
SUNY Community College	-7.2	-24.4
CUNY Senior College	+1.4	-8.5
CUNY Community College	+10.5	-5.6
Independent*	+0.1	-23.8
Proprietary**	--	-12.7
Part-Time Undergraduate		
SUNY State-Operated	-2.3	+2.1
SUNY Community College	+9.5	+3.6
CUNY Senior College	+2.1	-4.6
CUNY Community College	+5.2	-5.9
Independent*	+16.3	+0.3
Proprietary**	--	-9.4
Full-Time Graduate		
SUNY	-0.4	+1.8
CUNY	+4.4	-2.7
Independent	+10.3	-2.6
Proprietary**	--	***
Part-Time Graduate		
SUNY	+7.4	+9.6
CUNY	+3.8	+1.0
Independent	+12.1	+8.9

*Independent sector projections based on 84 of 118 institutions.

**Proprietary sector did not make projections for 1992.

***Only one institution has graduate enrollment in the proprietary sector.

Source: New York State Education Department, Bureau of Postsecondary Research, Information Systems, and Institutional Aid, 1984. Noted in the University of the State of New York, the State Education Department, The Regents Statewide Plan for the Development of Postsecondary Education in New York State, 1984, Volume II, p. 148.

Table 12

Projected NYS Population By Age Group

Age	Projected 1992	Percent Change
15-19	1,157,000	-24
20-24	1,348,200	-13
25-34	3,095,700	+9
35-44	2,674,400	+23
45-59	2,813,100	0

Source: New York State Department of Commerce, Spring 1983. Noted in the University of the State of New York, the State Education Department, The Regents Plan for the Development of Postsecondary Education in New York State, 1984. Volume II, p. 131.

Table 13

Projected High School Graduates, 1991-92 by Region

	Number	Percent Change
New York State	159,000	-30
Regions		
Western	14,590	-37
Genesee Valley	12,370	-37
Central	12,960	-31
Northern	2,910	-35
Northeast	15,570	-31
Mid-Hudson	19,460	-34
New York City	50,280	-20
Long Island	30,850	-33

Source: New York State Education Department, Information Center on Education, August 1983. Noted in the University of the State of New York, the State Education Department, The Regents Statewide Plan for the Development of Postsecondary Education in New York State, 1984, Volume II, p. 131.

consistency and fairness. We can raise these questions, but it's difficult to discuss them with the detail with which we've treated the technical design difficulties; there seems little other than assumptions to substantiate any response to them. The problems these questions suggest seem to be in the most basic nature of the plans and do not seem readily reducible by specific plan design. The questions are unsettling, and they suggest how deeply a proposal that seems narrowly financial relates to basic higher educational policy.

Some of the questions of consistency pertain in a most direct way to two of higher education policy's central criteria--choice and access.

- Students' Choices--Would the practical effect of a tuition futures plan be to prevent many students from selecting colleges that would be best for their interests and aptitudes? Many beneficiaries, as they were growing and approaching college age, would know that their parents had invested in plans at a particular set of colleges or even a single college. They would know that selections contrary to their parents' predictions could be costly. Could such knowledge subtly press a student with strong inclinations toward the liberal arts into enrolling at a college that emphasizes engineering? Worse, could such knowledge actually work to form a student's inclinations? Avoiding such an influence is a reason to design highly portable plans, but it's not clear that institutions can agree on and benefit from arrangements for highly portable plans.

- Institutions' Choices--Would there be similar pressure on college administrators? Rejecting an applicant who was a plan beneficiary, especially in a plan with provisions that leaned toward the investors' ideal, could mean that the college would have to return the investment. At a college with declining enrollments, that could mean foregoing entirely the amount of revenue which college budgeters had counted on for that enrollment slot. Would this situation--far from impossible at a time when the number of people of full-time student age is declining--cause administrators to implicitly alter their acceptance standards? Could it give plan beneficiaries a competitive advantage for acceptance over those not enrolled in plans (and especially over those who need financial aid)? (Theoretically possible, but highly unlikely, would be institutions' rejection of applicants in order to obtain withdrawal benefits in a plan oriented strongly toward the institutions' ideal plan.)

Such influence is contrary to a pro-choice policy, which is intended to increase the probability of matches between institutions' strengths and students' aptitudes.

The most apparent questions of fairness have to do with special subsidization of the college costs of plan participants. This subsidization would occur if projections were inaccurate.

- Would it be fair to non-participants if mistakes in plan projections required colleges to raise tuitions in order to make up incurred deficits? If this happened in an independent college consortium, the non-participating students would at least have the option of switching to public colleges or non-participating independent colleges. In a comprehensive institutional group (one including the public colleges), however, this option would not be available. The most obvious design feature to avoid this kind of subsidization would be to have future plan participants cover plan deficits by paying higher amounts for enrollment in the plan. But that would eventually reduce the plan's attractiveness to investors, and the number of plan participants could decline, perhaps to the point of negligibility.

- Would it be fair to taxpayers, some of whose children would be students not enrolled in the plan, if the State had to "bail out" the plan, use the government's borrowing capacity to fund it, or increase institutional aid in order to compensate for plan-incurred deficits?

Compounding the Penalty for Saving

Another question of fairness, however, occurs even if a plan works as it's supposed to and might apply to just about any use of savings to pay college costs. Is it fair to investors if, by virtue of their participation in a plan--that is, by virtue of their saving--their children end up being ineligible for tuition aid they otherwise would have received? Even though there is much machination in the attempt to secure IRS designation of tuition futures plans as "prepayment" rather than "savings," the practical fact is that tuition futures plans are essentially one means of inducing saving for college. The much-debated subtleties and uncertainties of plan design--gradations in portability, withdrawal rights, transferability and applicability to non-tuition college costs--suggest how blurry is the boundary between "prepayment" and "savings."

Here are some instances of how penalties for this saving could happen. The need assessment for federal guaranteed student loan eligibility is based on family assets. (4) If tuition futures benefits are considered an asset, they could render a student ineligible for a loan--a loan that might be needed to cover expenses not covered by the tuition futures plan (especially room and board). More complicated would be the relationship of tuition futures benefits to TAP awards. Need assessment for TAP eligibility is based not on total assets, but on income. (5) Tuition futures benefits, then, probably would not disqualify one from eligibility for a TAP award. Nevertheless, receipt of tuition futures benefits might still hold practical consequences for the beneficiaries.

- One consequence (one which could simply be incorporated among the risks borne by investors) would be that tuition futures benefits

would decline in value to the extent that TAP monies were available to beneficiaries. An investor would have rendered a payment in return for a full four years of tuition. But if the beneficiary qualified for TAP awards, the amount of tuition the investor would have in fact needed to cover would be less than full tuition. Whether this reduction in the value of the tuition futures investment would be great enough to make it a "bad" investment would depend greatly on the amount by which tuition exceeded the amount of TAP monies awarded; at very high-priced colleges, tuition futures could still turn out to be a bargain.

- If by some arrangement the fullest values of both the tuition futures investment and the TAP awards were paid to a beneficiary, the total amount available would exceed the tuition charges. The excess might be used for room and board and books, in which case someone--probably the beneficiary--would be liable for federal taxes on the monies used for expenses other than tuition.

The criteria for TAP awards have been specified in ways that qualify people whose parents have a relatively broad range of income. For awards which are less amply funded or for which demonstrated need must be greater, a reserve of tuition futures benefits could disqualify a beneficiary.

Some have argued that tuition futures programs, by reducing the number of middle-income students who need aid, will free aid for more use by lower-income students. This unquestionably is a potential, but it remains true that this freeing of aid would occur at the expense not of all middle-income people, but rather at the expense only of those who plan and save. And there also are lower-income people whose discipline would yield savings that would enable them to participate in a tuition futures plan; for them and others, the amount of saving necessary would be painful.

The idea that need-based aid penalizes savers applies not only to tuition futures proposals, but to most uses of saving for college costs. Taken alone, then, it probably would not be a compelling argument against the creation of a state tuition futures plan. A state tuition futures plan, however, could compound the unfairness--tuition futures is a form of saving which not only could disqualify students from aid, but would almost inescapably limit choice.

The Saving Incentive Problem

"Higher education . . . is conspicuously alone in creating a need for savings for which there is an acknowledged public value yet no public inducements

for private saving." (6) This statement by an authority on tuition futures plans reminds us, in this mostly fault-finding discussion, of the idea's virtue: a basic intention to encourage people to plan and save for college. But it does not seem unreasonable to hope that government could promote saving with means less labyrinthine and restrictive.

Federal Incentives: Indirect and Reduced

The current situation certainly exhibits room for initiative. Federal incentives to plan for children's college expenses were indirect from the start. But Congress, in its 1986 tax reforms, either deleted or restricted the traditional incentives, leaving means which require considerably more investment acumen. As one analyst has stated, "the new rules will force 'heavy emphasis on how to invest, as opposed to looking to tax vehicles to help in that process.'" (7)

The most important federal changes were to vehicles known as Clifford trusts and the Uniform Gifts to Minors Act.

- Clifford Trusts--This has been a standard way by which the federal government has assisted parents' attempts to accumulate funds to pay for college. Parents would establish a trust in the name of a child and would hold assets in that trust for ten years. During that time, the accumulating trust income would be taxed at the child's lower rate. Following the tax reform act, all Clifford trust income is taxed at the rate applicable to the person who established the trust. The tax changes with respect to Clifford trusts are expected to have the effect of abolishing them.

- Gifts to Minors--Gifts to minors, in contrast to Clifford trusts, are outright endowments of up to $10,000 per year ($20,000 for spouses) to children. Under the old tax law, income on this money was taxed at the child's lower rate. Under the new law, only the first $1,000 of earnings will be taxable at the child's rate if the child is less than 14 years old. If the child is at least 14, all earnings will be taxable at the child's rate. (8)

The lessened availability of tax benefits from the Uniform Gifts to Minors Act has caused tax analysts to suggest much more complicated investment strategies. The instrument in which one places the gift will differ depending on whether the child is at least 14 years old. Investors are advised to consider the array of securities that remain tax-exempt. Those serious about accumulating funds for their children's college expenses will now be carefully weighing the benefits of such instruments as AA-rated corporate and municipal bonds, single premium deferred annuities and AA-rated zero-coupon bonds.

So federal incentives to save for college expenses, never direct anyway, are reduced. And many of the more useful instruments for parents' gifts to minors, such as single-premium life insurance and tax-exempt bonds, require substantial discretionary income. Another shelter which Congress chose to preserve similarly requires a substantial asset: Those who own houses can borrow against the value of the home in order to obtain money for college expenses, and the interest they pay on that loan (in contrast to other kinds of loans to both parents and students for college expenses) is tax deductible.

The PASS Plan

New York State, in contrast, over the past ten years did attempt to induce saving especially for higher education and to do so in a fairly simple way. The Parent's and Student's Savings Plan (PASS) was a tax incentive; it was eliminated in 1987 by an act that adjusted the State's tax structure to the 1986 federal amendments.

The PASS Plan allowed New Yorkers to establish PASS funds for children, grandchildren, siblings, nieces or nephews. A beneficiary had to be a dependent of the person who established the fund. A benefactor could deposit up to $750 per year per beneficiary and deduct that amount from the benefactor's New York State taxable income. Fund earnings were exempt from State taxes. PASS funds could be used to pay for tuition and fees, room and board, books, supplies and equipment.

It's commonly said that the PASS program did not induce much saving. There is no evidence to the contrary, but there appears to be no published study which would substantiate that contention. Table 14 provides some data. (The available statistics cover years only through 1983, after which it was possible to take the PASS deduction without specifically listing it on a return; this made it more difficult to measure.) The State Bureau of Tax Statistics estimates that the PASS deduction was claimed on only 15,000-to-20,000 out of the annual total of about 7-8 million State personal income tax returns. (9)

If a PASS fund was used for purposes other than those which qualified a contributor for the tax benefits, the monies were treated as ordinary income and subjected to special taxation that recaptured the deduction for the State. This is rarely mentioned, however, as a reason for the perceived lack of use. Instead, it's suggested that a $750 contribution was too little relative to total college expenses and that State taxation in any case is too low (frequent complaints to the contrary notwithstanding) for a PASS fund to have been a worth-

Table 14
PASS Plan Participation

	Number of Returns (thousands)	Total Amount of Deduction Claimed (millions)
1980	17.8	$21.0
1981	15.0	16.7
1982	13.2	14.0
1983	14.1	16.4

Source: New York State Department of Taxation and Finance, Bureau of Tax Statistics.

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while place to put money. Also, the qualified trustees of PASS funds were mainly banking institutions, offering lower rates of return than, for instance, brokerage houses (with which investors can place IRAs).

So with the repeal of the PASS Plan, especially, it does seem fairly clear that there is little public inducement for saving toward higher education, despite the capital investment value such saving clearly would have for the economy.

Fair Shares

The future trend of college costs in general and tuition fees in particular will be of interest not only to those directly involved in higher education, but to all of us. There may be too much alarm at recent tuition increases--they could turn out to be mere aberrations or otherwise temporary adjustments. However, if inflation in college costs does continue to outstrip the average family's income growth (and perhaps even if it doesn't), student borrowing will further rise and pressure will further build on institutions to cut costs and on states to increase institutional and student aid.

The burden of financing college education is distributed among government, parents, and students. Colleges, in addition, receive money from donors. The distribution continuously, if slowly, fluctuates among the bearers and varies from state to state. Some expect that donations, especially important to inde-

pendent colleges, will decline now that the federal government has reduced tax incentives for charitable contributions.

One of the reasons other states' movement toward tuition futures plans has been faster probably is that they provide less support than does New York--in effect, they do less to control the ratio of tuition fees to average income. Relative to a Pennsylvania tuition futures proposal, for instance, one journal observed that "the proposal has bipartisan support and may be part of the solution to Pennsylvania's underfunding of higher education and resulting tuition hikes. Education Daily reports that Pennsylvania ranks 50th among all states in per capita spending on higher education." (10)

Some who propose a tuition futures plan for New York have asserted that it's important to assure the people that enacting a plan does not constitute a lessening of the State's commitment to higher education. It seems as important, however, not to understate the implications of such an enactment. Perhaps plan advocates, in their assurances, mean simply that an enactment should not be used as a pretext to reduce the existing State commitment. Or they may mean that it would free an amount, currently used for student aid, which the State could use for needier students or for student aid innovation. Nevertheless, it's less than candid to suggest that a tuition futures plan or any other kind of college saving incentive is not intended to ease the developing college cost crunch by drawing more private money, by means other than student loans, into the equation.

It's well settled that the State is responsible for ensuring reasonable levels of quality, access and choice in higher education. Less settled, but nevertheless often acknowledged, is that people share some responsibility for their own and their children's college educations.

A tuition futures plan is one way by which people could be encouraged to carry that responsibility. While we think it an inadvisable way, we acknowledge that some inducement is necessary and appropriate. As valuable and necessary as higher education is, there are other vital matters for which the State must spend money. And while there is public value in individuals' college educations, there also is plenty of private value. Private commitment to higher education, then, should be integral and fostered.

But in casting about for the best means of encouraging people to carry that portion of the load which is a private responsibility, we must remember that different means, while perhaps drawing the same amount of money into the equation, have sharply different and important implications. We have pointed out, for instance, that a tuition futures plan would compound the penalty which savers

experience--not only could it disqualify them from some need-based aid, but it would reduce choice. There is, as well, an important distinction between a financing scheme that depends on students' borrowing and a scheme that depends on use of parents' assets (whether it be through established savings or through parents' borrowing). One economist, a leading authority on higher educational finance, suggests that societies have an elemental alternative:

- Each generation could finance its own college education, mostly by borrowing the necessary funds and repaying them over a number of years that reflects the lifetime nature of this investment.
- Each generation could finance the college education of its children by applying its own assets, through savings or borrowing. (11)

In effect, Americans have chosen a mix. Lately, borrowing by students has become far more important in the mix, but the amount of time permitted to repay the loans has perhaps not been sufficiently recalibrated to reflect the rising student indebtedness. One result seems to be that students' fears about debt burdens are affecting their choices of majors and careers. So again we see that particular means to incorporate private funds into the college finance equation affect choice in a serious way. We may see, for instance, even fewer people becoming teachers and nurses as the oversupply of corporate lawyers increases.

The institutions, too, have some responsibility for a contribution. Those individuals demanding cost-cutting in college budgets should be sensitive to the differing financial straits of elite and non-elite institutions. And they ought not forget that while factory-like methods are available and perhaps even used at some of the nation's colleges, such methods will cause injury to quality--injury difficult to measure as exactly as we measure budget deficits, but injury nonetheless. In the long run, permitting shoddiness is the least effective way for any enterprise to ensure its survival; it bears repeating that technological societies and economies especially need not a simple issuing of credentials, but education that is truly higher.

However, not even higher education can be held exempt from economics: If costs continue to increase faster than people's and the State's abilities to pay, colleges must continue to try to control costs. Many college administrators already scrutinize their operations to find and eliminate waste. As financial pressures mount, fewer of them may be able to limit scrutiny to relatively uncontroversial matters such as travel budgets and food services; instead, many colleges will have to intensify the financial examination of already contentious

matters such as administrative and faculty salaries, workload and tenure decisions, and construction. The necessary bargaining and painful allocation of resources will consume time, test morale, and require innovation in staffing and practice in order to avoid harm to scholastic quality.

As our recommendations will set forth, we think there is much merit to an enhanced tax-incentive, one that does not require the penalties inherent to state tuition futures plans; we urge the Legislature to redevelop and reenact one as part of a broad effort to arrive at the most productive distribution of the college financing burden. But even if such an incentive proves to be powerful in drawing the necessary private funds into college financing, we can expect a continuing and perhaps quickening evolution of the college student profile to require college financing to undergo fine tuning and remodeling in the coming decade. The number of students of traditional college age is declining; more and more, students will come from older age groups. They will be employed; they will have some assets; and they will be financing not their children's education, but their own continuing education.

Such evolution will apply new pressures on college budgets--fewer students overall will mean higher tuitions, perhaps some losses of colleges, and a continuing need to develop programs for the needs of people who have already attained a degree. But it will, as well, provide new opportunities. As lesser populated cohorts move into the workforce, employers will have an increased need to develop, retain and retrain employees, and they may be correspondingly willing to assume a greater share of the burden of educating them. Cooperative education perhaps will become more common.

As higher education and public financing continue to evolve, so too must private financing. Family savings are becoming a more critical part of the college cost-resources equation; it's sensible, then, that governments should promote saving. With tax incentive initiatives, and college financing initiatives generally, the federal government is inescapably a critical participant. The federal tax load certainly provides far greater opportunity than can any state for development of a powerful tax incentive. But with or without imagination and will on the part of the federal government, the facts of college financing require New York State to continue to experiment. It was a New York State program which provided the model for the federal guaranteed student loan program. Inasmuch as New York State, in its size and in its institutional diversity, resembles the nation's diversity more than do the other states, it's not unreasonable to expect that successful experiments here will again stimulate federal efforts.

RECOMMENDATIONS

Tuition Futures: A Cautious Development

Our first recommendation regarding tuition futures plans is simple: The Legislature ought not enact a plan in the very near future and should instead consider alternative means of managing the problem of tuition financing.

There are questions of fairness inherent to any guarantee plan. But the sheer size of the independent sector in New York makes a workable program much harder to design than it would be in most other states.

If the Legislature should decide to establish a guarantee program, we would urge this guideline: Explore all possibilities of making it comprehensive. The plan should not only include both public and independent colleges, but it should also treat their respective primary cost problems: tuition at the independents, room and board at the publics.

One of the points on which we have been unable to offer measurement is the degree of parents' anxiety about college costs generally and tuition in particular. The greater the anxiety, the more valuable a guarantee would be, even with its drawbacks.

The Legislature, if it found that the public's anxiety is such that a guarantee plan is warranted, might establish a plan. It would, then, have to implicitly or explicitly consider whether or not it wishes the independent sector to continue to play as significant a role as it has so far. A plan which included only the public institutions would be much easier to design, but it probably would intensify competitive pressures on independent colleges. And a tuition plan only for the publics would ignore their primary cost problem: room and board.

We have stated that a guarantee plan in New York State would be harder to design than it would be elsewhere. Nevertheless, it's conceivable that institutions could agree on the revenue-sharing arrangements necessary for a statewide plan that embraced both public and independent institutions. The more aggressive was the State's risk-sharing, the more easily conceivable such design would be. College administrators' and investors' willingness to participate would depend on the degree of security the plan offered. The more the State indemnified each against potential losses, the greater would be the likelihood of the plan becoming a major factor in higher education finance.

So if they choose to establish a comprehensive guarantee plan, policymakers will not only be assuming the burden of a difficult design problem; they also will be making a difficult decision about the degree of potential liability to which they are willing to commit the State.

Encouraging Planning

We recommend that the Legislature develop means of encouraging parents and others to plan for college costs through vehicles more flexible than tuition futures. We urge the Legislature to investigate and approve a college saving incentive that provides students maximum choice among colleges, creates funds usable for all college expenses, and limits State liability and involvement to that implicit in a tax incentive. We urge it also to direct the State Education Department and the Department of Taxation and Finance to monitor the success of the incentive and, periodically and by specified dates, suggest alterations that might improve its efficiency.

Parents' planning for college costs is clearly valuable. It may be that increases in the cost of higher education will for some time continue to exceed increases in the Consumer Price Index, and it's unrealistic to expect that institutions and the state's taxpayers will be willing or able to pay for such increases in their entirety. Student borrowing, at least with the repayment periods in current loan programs, may well have reached its sensible limit. And borrowing is often an inefficient form of capital investment (in this case, human capital investment)--the weight of debt repayment, both for individuals and for the economy as a whole, can become so great that it seriously restricts the ability to further develop capital. It's important, therefore, to alert parents to the importance of saving for college costs and to encourage such saving.

It's not unreasonable to ask whether it's sensible to offer part of the State's tax base as an incentive for college saving; there must be limits to this mode of State investment, and the recent federal and State tax reforms drew those limits much tighter. With regard to incentives for college saving, however, we suggest not only that it might have been a mistake to eliminate the PASS Plan, but that it has been a mistake of the federal government through the years not to structure its intergeneration transfer tax shelters explicitly to encourage college saving.

The fiscal argument for a college saving incentive is traditional, but still valid: government's additional contribution to higher education in the form of a tax incentive will lever far greater private assets. More important, however, is the public purpose--the economic argument--for this leverage. For in contrast to many purposes for which parents may have transferred income to their children, the college education of a child is the creation of an asset that serves the entire economy and society. Our recommendation for reestablishment of this kind of tax incentive program, then, is also a recommendation that the State offer to the federal government an example of policy which recognizes the public value of college education in the same way that it recognizes the desirability of home ownership, for which tax incentives have long existed and remain.

We recognize that this approach might seem inconsistent with recent federal income tax policy and that federal tax incentives (State taxes being far lower) might be necessary to increase savers' interest significantly. However, the cost of college is clearly a matter of intense national debate, and pressure to alter the federal tax code will be correspondingly intense. In the meantime, states can usefully explore variations in tax incentive programs; a New York State college financing initiative could serve as a model for federal action, as it did relative to guaranteed student loans.

To employ a tuition guarantee program as the incentive for saving would be to start with an incentive that in most forms is not very flexible: It would practically reduce students' choices of college, would be difficult to use for expenses other than tuition, and would subject investors or institutions or both to the potential of significant financial losses if their projections of students' selections and costs of education were inaccurate.

It seems unlikely, but perhaps we will eventually discover that a guarantee is the only incentive sufficient to induce parents to save specifically for college costs. There seems little reason, however, to leap to that conclusion and thereby assume the disadvantages of a guarantee program. Instead, there is

much room to experiment with efforts to mark college education at last as a public purpose for which special and powerful tax incentives for saving are warranted. And it is with an experimental attitude that we might best initiate this effort, for the PASS Plan seems not to have generated saving in significant volume. Some differences from the PASS Plan at the start, and some monitoring and tinkering with an incentive during its early years, make sense.

Avoiding the complications of tuition guarantees would make design of an incentive considerably easier, but there still would be choices of consequence.

Kinds of Incentives--Typical incentives are:

- deductions of payments into special accounts; and
- exemptions of interest earnings on those payments.

The Legislature could authorize either or both. An alternative is to tax special funds, but at a lower rate. Some have even suggested that the State deposit matching funds into the special accounts established by investors who have less than a specified level of income.

Size of Incentive--Deductibility could be limited to some absolute amount or accorded to entire payments, whatever the amount. Exemption of earnings could likewise be limited or unlimited.

Another way to limit the tax benefits would be to limit the amount investors can deposit in the special fund; the tax incentive would be applicable to that entire amount. It might be more sensible, however, to simply limit applicability of the tax benefits to a specified amount of deposit. That way, an investor who was highly motivated to save for college costs would be free to deposit additional amounts; those extra amounts would still earn interest, but they would not be deductible, and the earnings would be taxable. Another alternative would be to reduce (rather than completely withhold) the incentive for additional amounts by prohibiting deduction of additional deposits, but permitting exemption of the earnings on those deposits.

No doubt there is an optimum to be sought. The PASS Plan was too small an incentive to generate much saving. But after finding a threshhold of incentive that does induce significant saving, policymakers must also be sensitive to that point at which the increments of saving induced by increments of the incentive begin to decline. Too much leverage wastes the tax base.

Nature and Extent of State Involvement--The mode of least state involvement is the one that probably comes quickest to most minds: the State could simply authorize the incentives in the way it authorized the PASS Plan and the federal government authorized Individual Retirement Accounts. Monitoring and studying the performance of the incentives would require closer attention than the PASS Plan received. Nevertheless, this approach would create little need for bureaucracy beyond the capacities that exist already in the Department of Taxation and Finance.

Some proposals would require considerably more bureaucracy. Rather than directing payments toward traditional investment instruments, a state could designate a public authority to receive and accumulate the payments and reinvest them in the manner of a mutual fund. Such intensive state administrative involvement could probably be justified only by other involvement beyond simple state tax incentives. For instance, an Illinois proposal would authorize a public authority to sell federal tax-exempt general obligation bonds and convert the proceeds to "college savings certificates" in an attempt to pass the exemption through to parents saving for college.

Restrictions--In general, the greater the incentive, the more policymakers might wish to restrict use of the monies. But while it would take very great restrictiveness for a tax-incentive program to be as inflexible as a guarantee plan, it would be wise to remember that restriction does reduce the incentive.

In fact, some of the restrictions suggested in one proposal or another are similar or identical to those that are part of the design problem in tuition guarantee proposals.

- Withdrawal--Penalties for withdrawing funds for purposes other than college generally would be determined by the size of the tax benefit the investor had obtained. This contrasts with tuition futures plans, in which plan feasibility could depend on a confiscatory kind of penalty. If for some reason the State did impose a punitive tax, the tax (like tuition futures withdrawal penalties) presumably would not be applicable in some cases (e.g., if the beneficiary died or won a full scholarship).

- Transferability--The State might allow use of the monies by a person other than the one for whom a fund was established, but perhaps only if that person was an immediate member of the family.

- Age and Time--The State could require that funds be established only for dependent minors and that they be used by a specified age (e.g., 25).

- In-State Colleges--Those who wish to discourage residents from emigrating for their college education might wish the State to reclaim the tax benefit for funds spent at out-of-state colleges. An alternative might be a state-funded bonus for matriculation at an in-state college.

A possible restriction which relates more narrowly to tax incentive plans has to do with qualified instruments. The federal government permits IRA investors to place their funds in higher-risk instruments like common stocks. And in the pursuit of the higher returns which higher-risk investments offer, IRA investors sometimes lose their money. Inasmuch as a tax incentive does constitute a financial investment by the State, policymakers might wish to ensure that investors do not fritter it away; that is, they may wish to restrict investments to safer instruments in order to ensure that the public purpose for which they established the incentive is served. Most common savings instruments offered by banking institutions, for instance, offer low returns, but high (federally insured) security. (This concern would exist even if the State established a public authority to receive and reinvest the payments. Recent losses by school districts in the Lion Capital Group-RTD Securities case remind us that public entities, too, can fritter away their assets through investment mistakes.)

Each added restriction can help to ensure that special funds will be used for the public purpose for which they were established. The more elaborate the public purpose is, the more restrictions will be necessary. For instance, prohibition on use of funds out of state would reduce students' choices and might even invite retaliatory legislation. However, if the public purpose of an incentive is not only to induce saving, but also to induce New York students to settle at home, prohibition on use of funds out of state might make sense.

Development of a new tax incentive might wisely include a study of the PASS Plan. Surveys to ascertain reasons for its failure and some comparison with other kinds of tax incentives might suggest the size and nature of incentives needed in order to induce saving of the degree needed to finance college.

Legislatures in other states, too, are considering proposals for tax incentives, and it might be instructive to examine their experiences and deliberations. Among the proposals exhibiting interesting features for study are some in Missouri, Illinois, Georgia and Pennsylvania. In addition, New York State's Board of Regents has added an incentive initiative to its agenda of legislative proposals. (Appendix 2 describes these state proposals as well as two federal proposals.)

APPENDIX 1

SOME TUITION FUTURES LAWS AND BILLS

State Laws

Tuition futures bills have been enacted in six states: Michigan, Wyoming, Tennessee, Indiana, Florida and Maine.

Michigan — Michigan Education Trust
Enrolled House Bill No. 5505
Approved by the Governor Dec. 23, 1986

The Michigan plan has been the model for most other state plans. Key points of the Michigan plan include the following:

- It is pending a ruling from the IRS concerning its tax status.
- It offers withdrawal options--Plan A and Plan B--which allow for either withdrawal of principal only or withdrawal of principal plus interest.
- It is intended for use primarily at the State's public institutions, although funds can also be used at independent institutions.

Because the Michigan plan is representative of a good number of state plans, a copy of the law is included in this appendix.

Wyoming — Advance Payment of Higher Education Costs
Enrolled Act No. 9
Senate, Approved by the Governor Feb. 19, 1987

Wyoming's plan is designed for a relatively simple academic system: one four-year public university and seven community colleges (there are no independent institutions in the state). The program is to be administered

primarily by the Deputy Treasurer of the University of Wyoming's Board of Trustees. There are four payment options: resident or nonresident tuition for a community college, and resident or nonresident tuition for the University of Wyoming. A striking feature is that room and board costs are also covered in all of the contract options. There is a lag of ten years between the time the contracts are signed and the time the beneficiaries may actually enroll at college. Participants may withdraw from the plan at any time, and the refund shall be the principal plus four percent compounded interest. No state tax benefits are offered, but tuition is very low (approximately $300 in-state and $1,200 out-of-state), so tax benefits would not prove to be strong incentive, anyway. (1)

Tennessee — Tennessee Baccalaureate Education System Trust Act
House Bill No. 618
Approved by the Governor May 4, 1987

The Tennessee plan is similar to the Michigan Education Trust, but simpler on several counts: The relationship of the purchaser and the beneficiary with the trust is not stressed; contract terms between these parties are left for the administering agent to determine. The law does not provide the withdrawal options contained in the Michigan plan. Special attention is given to the formation of the governing board. No contract can be entered into without the board making known the tax status. The trust funds are state tax-exempt.

Indiana — Baccalaureate Education System Trust (BEST)
House Bill 1018
Approved by the Governor May 1987

The basic structure of House Enrolled Act No. 1018 is similar to Michigan's plan, but there are some differences. The investment vehicles are detailed, as are the conditions for use of these vehicles. As with Michigan, there are contracts offering different withdrawal options (Plan A offers a refund of principal without interest earnings; Plan B offers a refund of principal plus interest). But Indiana's program offers a third contract--Plan C--which is designed strictly for two-year public institutions. The law directs that in needs analysis for the calculation of awards, tuition futures benefits shall be

regarded as parental contributions. The powers and responsibilities of the State institution trustees to set and establish required semester charges shall not be superseded by the trust or the State. The State and State institutions are not responsible for meeting the conditions of the contract or any liabilities of the fund.

Florida — Florida Prepaid Postsecondary Education Expense Program
CS/CS/HBs 47 & 17, 2nd Engrossed
Enacted June 1987

Like the Michigan plan, Florida's Prepaid Postsecondary Education Expense Program is to be administered by a governing board. The board is to establish a comprehensive investment plan with specified investment vehicles. In addition, the board is to designate a marketing agent and contract for the services of a records administrator, a trustee services firm and authorized insurers, banks and investment companies. Advance payment contracts will cover at least three plans: the community college plan, the university plan, and the dormitory residence plan. Funds in any of these plans may be applied toward payment at certain independent institutions located in Florida. The board must make the IRS ruling on the tax status known before entering into an advance payment contract. State employees can make payments through payroll deductions. The law directs that the Legislature shall appropriate to cover shortfalls.

Maine — Student Educational Enhancement Deposit Plan
LD 779
Enacted June 18, 1987

Committee Amendment "A" to LD 779
H-259

Senate Amendment "A" to Committee Amendment "A" to LD 779
S-246

Maine's plan is similar to the Michigan plan in terms of the establishment of a board, termination and refund policies, and handling of assets in the fund. The board may contract with external agents for management and operation services. Plan A, offering a refund of the face amount of the investment, and Plan B, offering a refund of the face amount plus interest, are offered. The

board must make the IRS ruling on the tax status known before entering into an advance payment contract. The fund is state tax-exempt and is intended for public institutions; two-year vocational-technical institutes and community colleges are included. Funds may be transferred to independent institutions if the contract is first terminated (with the refund not exceeding the highest public tuition rate).

H-259 supplies an emergency preamble, which puts the plan into effect immediately. An appropriation of $25,000, provided to cover initial administrative expenses, is to be repaid before July 1, 1989. A fiscal note recognizes the revenue loss that would be caused by tax-exempt status, although the amount of the loss cannot be specified. The note also recognizes that by 1988-89, the General Fund will have recovered the initial appropriation. S-246 changes the appropriation amount to $10,000 and deletes mention of the revenue loss from the fiscal note.

Federal Proposals

H.R. 2509 Parental Assistance for Tuition Investment Act of 1987
Introduced May 1987

H.R. 2509, which would create a National Postsecondary Education Trust, is similar in several respects to state legislation following Michigan's model. S. 1572, known as the National Education Savings Trust Act of 1987 (NEST) and introduced July 30, 1987, is similar to H.R. 2509. H.R. 2509 would establish a trust, governed by a board including the Secretary of Education, the Secretary of the Treasury and ten Presidential appointees. The general duties of the trust, use and disbursal of the funds, reporting requirements, and termination criteria would generally be the same as specified in state plans. The trust would attempt to obtain investment returns sufficient to cover its projections of average tuition and fees charged at public and private colleges.

There are provisions that would permit a purchaser to transfer benefits to another beneficiary and pay by installment (including through payroll deductions). Refunds would be disbursed in single payments. The tuition payment plan agreement would not be a promise of acceptance at any institution. Appropriations would be provided for start-up costs.

A good portion of this proposal deals with tax benefits. Deductions of up to $2,000 a year ($48,000 total for all taxable years) would be permitted subject to specified limits (e.g., the beneficiary dies or attains the age of 25; the taxpayer is the beneficiary). Benefits would not be included in gross income if they were used for educational purposes.

H.R. 2404 Higher Education Prepayment Tax Act of 1987
Introduced May 1987

H.R. 2404 would amend the Internal Revenue Code to exclude from gross income the benefits earned under certain tuition futures plans, including institutional plans and state plans.

STATE OF MICHIGAN
83RD LEGISLATURE
REGULAR SESSION OF 1986

Introduced by Reps. Kosteva, Lynn Owen, Busch, Leland, Barns, Hillegonds, Bartnik, Hood, Stabenow, Gubow, Saunders, Ciaramitaro, Hunter, Harrison, Mathieu, Knight, Porreca, Sitz, Stallworth, Smith, Emerson, Koivisto, Gagliardi, Dutko, Terrell, Dodak, Scott, Keith, Nash, Bennett, Rocca, Weeks, Berman, Oxender, Bender, Jondahl, DeMars, Hertel, Palamara, Joe Young, Jr., Griffin, Gnodtke, Trim, Richard A. Young, Brown, Honigman, O'Neill, Bennane, Cherry, Alley, Joe Young, Sr., Geerlings, Fitzpatrick, Stopczynski, London, Perry Bullard, Clack, Murphy, Hollister, Kilpatrick, Maynard, Willis Bullard, Muxlow and Jacobetti

Rep. Hoffman named co-sponsor

ENROLLED HOUSE BILL No. 5505

AN ACT to create the Michigan education trust; to prescribe the powers and duties of the trust and of its board of directors; to provide for advance tuition payment contracts; to establish an advance tuition payment fund and to provide for its administration; to provide for remedies; and to repeal certain acts and parts of acts on specific dates.

The People of the State of Michigan enact:

Sec. 1. This act shall be known and may be cited as the "Michigan education trust act".

Sec. 2. The legislature hereby finds and declares the following:

(a) It is an essential function of state government to forever encourage schools and the means of education, as provided in section 1 of article VIII of the state constitution of 1963.

(b) It is a responsibility of state government to maintain state institutions of higher education as provided by section 4 of article VIII of the state constitution of 1963.

(c) It is an essential function of state government to encourage attendance at state institutions of higher education.

(d) Tuition costs at public institutions of higher education are difficult for many to afford and are difficult to predict in order to enable individuals and families to plan.

(e) It is in the best interest of the people of this state to foster public higher education in order to provide well-educated citizens.

(f) It is in the best interest of the people of this state to encourage state residents desiring a public higher education to enroll in state public institutions of higher learning.

(g) It is in the best interest of the people of this state to enhance and foster the ability of Michigan residents to choose an independent, nonprofit higher education in order to provide well educated citizens and to encourage state residents desiring an independent higher education to enroll in an independent degree-granting college or university located in this state.

(h) Students in elementary and secondary schools tend to achieve to a higher standard of performance when the payment of tuition for their higher education is secured.

(i) Providing assistance to assure the higher education of the citizens of this state is necessary and desirable for the public health, safety, and welfare.

Sec. 3. In light of the findings described in section 2, the legislature declares the purposes of this act and of the Michigan education trust created by this act to be:

(a) To encourage education and the means of education.

(b) To maintain state institutions of higher education by helping to provide a stable financial base to these institutions.

(c) To provide wide and affordable access to state institutions of higher education for the residents of this state.

(d) To encourage attendance at state institutions of higher education.

(e) To provide students and their parents economic protection against rising tuition costs.

(f) To provide students and their parents financing assistance for postsecondary education at a Michigan institution of higher education of their choice.

(g) To help provide the benefits of higher education to the people of this state.

(h) To encourage elementary and secondary students in this state to achieve high standards of performance.

Sec. 4. As used in this act, except where the context clearly requires otherwise:

(a) "Advance tuition payment contract" means a contract entered into by the trust and a purchaser pursuant to section 6 to provide for the higher education of a qualified beneficiary.

(b) "Board" means the board of directors of the Michigan education trust described in section 10.

(c) "Fund" means the advance tuition payment fund created in section 9.

(d) "Purchaser" means a person who makes or is obligated to make advance tuition payments pursuant to an advance tuition payment contract.

(e) "Qualified beneficiary" means any resident of this state.

(f) "State institution of higher education" means a college or university described in section 4, 5, or 6 of article VIII of the state constitution of 1963 or any 4-year degree-granting institution established by the state after the effective date of this act, which institution is designated by the state as a state institution of higher education for purposes of this act.

(g) "Trust" means the Michigan education trust created in section 5.

(h) "Tuition" means the quarter or semester charges imposed to attend a state institution of higher education and all mandatory fees required as a condition of enrollment as determined by the board.

(i) "Weighted average tuition cost of state institutions of higher education" means the tuition cost arrived at by adding the products of the annual undergraduate tuition cost at each state institution of higher education and its total number of undergraduate fiscal year equated students, and then dividing the gross total of this cumulation by the total number of undergraduate fiscal year equated students attending state institutions of higher education.

Sec. 5. (1) There is created a public body corporate and politic to be known as the Michigan education trust. The trust shall be within the department of treasury, but shall exercise its prescribed statutory powers, duties, and functions independently of the head of that department.

(2) The purposes, powers, and duties of the Michigan education trust are vested in and shall be exercised by a board of directors.

Sec. 6. (1) The trust, on behalf of itself and the state, may contract with a purchaser for the advance payment of tuition by the purchaser for a qualified beneficiary to attend any of the state institutions of higher education to which the qualified beneficiary is admitted, without further tuition cost to the qualified beneficiary. In addition, an advance tuition payment contract shall set forth in a clear, understandable manner all of the following:

(a) The amount of the payment or payments required from the purchaser on behalf of the qualified beneficiary.

(b) The terms and conditions for making the payment, including, but not limited to, the date or dates upon which the payment, or portions of the payment, shall be due.

(c) Provisions for late payment charges and for default.

(d) The name and age of the qualified beneficiary under the contract. The purchaser, with the approval of and on conditions determined by the trust, may subsequently substitute another person for the qualified beneficiary originally named.

(e) The number of credit hours covered by the contract.

(f) The name of the person entitled to terminate the contract, which, as provided by the contract, may be the purchaser, the qualified beneficiary, or a person to act on behalf of the purchaser or qualified beneficiary, or any combination of these persons.

(g) The terms and conditions under which the contract may be terminated and the amount of the refund, if any, to which the person terminating the contract, or specifically the purchaser or designated qualified beneficiary if the contract so provides, shall be entitled upon termination.

(h) The assumption of a contractual obligation by the trust to the qualified beneficiary on its own behalf and on behalf of the state to provide for credit hours of higher education, not to exceed the credit hours required for the granting of a baccalaureate degree, at any state institution of higher education to which the qualified beneficiary is admitted. The advance tuition payment contract shall provide for the credit hours of higher education that a qualified beneficiary may receive under the contract if the qualified beneficiary is not entitled to in-state tuition rates.

(i) The period of time from the beginning to the end of which the qualified beneficiary may receive the benefits under the contract.

(j) All other rights and obligations of the purchaser and the trust.

(k) Other terms, conditions, and provisions as the trust considers in its sole discretion to be necessary or appropriate.

(2) The form of any advance tuition payment contract to be entered into by the trust shall first be approved by the state administrative board.

(3) The trust shall make any arrangements that are necessary or appropriate with state institutions of higher education in order to fulfill its obligations under advance tuition payment contracts, which arrangements may include, but need not be limited to, the payment by the trust of the then actual in-state tuition cost on behalf of a qualified beneficiary to the state institution of higher education.

(4) An advance tuition payment contract shall provide that the trust provide for the qualified beneficiary to attend a community or junior college in this state before entering a state institution of higher education if the beneficiary so chooses and that the contract may be terminated pursuant to section 8 after completing the requirements for a degree at the community or junior college in this state or before entering the state institution of higher education.

(5) An advance tuition payment contract may provide that, if after a number of years specified in the contract the contract has not been terminated or the qualified beneficiary's rights under the contract have not been exercised, the trust, after making a reasonable effort to locate the purchaser and qualified beneficiary or the agent of either, shall retain the amounts otherwise payable and the rights of the qualified beneficiary, the purchaser, or the agent of either shall be considered terminated.

Sec. 7. (1) At a minimum, the trust shall offer advance tuition payment contracts of the 2 types set forth in subsections (2) and (3), to be known as Plan A and Plan B, respectively.

(2) Under Plan A:

(a) A payment or series of payments shall be required from the purchaser on behalf of a qualified beneficiary.

(b) If an advance tuition payment contract is terminated before a qualified beneficiary earns a high school diploma or reaches the age of majority, or pursuant to section 8(1)(d), the trust shall refund the face amount of the payment or payments in accordance with the terms of the contract, less any administrative fee specified in the contract, but shall not refund any investment income attributable to the payments.

(c) Except as provided in subdivision (d), the trust shall provide for the qualified beneficiary to attend a state institution of higher education at which the qualified beneficiary attends for the number of credit hours required by the institution for the awarding of a baccalaureate degree, without further tuition cost to the qualified beneficiary, except as provided in section 6(1) for a qualified beneficiary who is not entitled to in-state tuition rates.

(d) As an alternative to subdivision (c), the trust shall provide for the qualified beneficiary to attend a state institution of higher education at which the qualified beneficiary attends for a fixed number of credit hours, as permitted by the trust, less than the total number of credit hours required by the institution for the awarding of a baccalaureate degree, without further tuition cost to the qualified beneficiary for that fixed number of credit hours, except as provided in section 6(1) for a qualified beneficiary who is not entitled to in-state tuition rates.

(3) Under Plan B:

(a) A payment or series of payments shall be required on behalf of a qualified beneficiary.

(b) If an advance tuition payment contract is terminated before a qualified beneficiary earns a high school diploma or reaches the age of majority, or pursuant to section 8(1)(d), the trust shall refund the face amount of the payment or payments in accordance with the terms of the contract, less any administrative fee specified in the contract, together with all or a specified portion of accrued investment income attributable to the payment or payments as may be agreed to in the contract.

(c) Except as provided in subdivision (d), the trust shall provide for the qualified beneficiary to attend a state institution of higher education at which the qualified beneficiary attends for the number of credit hours required by the institution for the awarding of a baccalaureate degree, without further tuition cost to the qualified beneficiary, except as provided in section 6(1) for a qualified beneficiary who is not entitled to in-state tuition rates.

(d) As an alternative to subdivision (c), the trust shall provide for the qualified beneficiary to attend a state institution of higher education at which the qualified beneficiary attends for a fixed number of credit hours, as permitted by the trust, less than the total number of credit hours required by the institution for the awarding of a baccalaureate degree, without further tuition cost to the qualified beneficiary for that fixed number of credit hours, except as provided in section 6(1) for a qualified beneficiary who is not entitled to in-state tuition rates.

(4) Contracts required to be offered by this section may require that payment or payments from a purchaser, on behalf of a qualified beneficiary who may attend a state institution of higher education in less than 4 years after the date the contract is entered into by the purchaser, be based upon attendance at a certain state institution of higher education or at that state institution of higher education with the highest prevailing tuition cost for the number of credit hours covered by the contract.

(5) Contracts required to be offered by this section shall be offered with 2 alternatives. One alternative shall offer advance tuition payment contracts that provide the credit hours of higher education necessary for the granting of a baccalaureate degree at any of the state institutions of higher education. The second alternative shall provide that the number of credit hours of higher education a qualified beneficiary may receive under the contract will be reduced to a percentage of the credit hours required for the granting of a baccalaureate degree at a state institution of higher education, as specified in the contract, if the qualified beneficiary enrolls in a state institution of higher education imposing at the time the qualified beneficiary enrolls an annual tuition rate that is greater than 105% of the weighted average annual tuition rate of all state institutions of higher education. This subsection shall not preclude a state institution of higher education at which a qualified beneficiary is entitled to receive less than the minimum number of credit hours required for the granting of a baccalaureate degree from providing that qualified beneficiary, without further tuition charges, the additional credit hours necessary to receive a baccalaureate degree.

(6) If a beneficiary of an advance tuition payment contract with either an alternative 1 or alternative 2 designation, as described in subsection (5), attends a community or junior college for 2 years at the in-district tuition rate, that beneficiary then may attend any state institution of higher education at no additional tuition cost and receive the number of credit hours necessary for the awarding of a baccalaureate degree.

Sec. 8. (1) An advance tuition payment contract shall authorize a termination of the contract when any 1 of the following occurs:

(a) The qualified beneficiary dies.

(b) The qualified beneficiary is not admitted to a state institution of higher education after making proper application.

(c) The qualified beneficiary certifies to the trust that he or she has decided to attend and has been accepted by a Michigan independent, degree-granting institution of postsecondary education recognized by the state board of education or, after he or she has a high school diploma or has reached the age of majority, he or she has decided not to attend a state institution of higher education and requests, in writing, before July 15 of the year in which the qualified beneficiary desires to terminate the contract, that the advance tuition payment contract be terminated.

(d) Other circumstances, determined by the trust and set forth in the advance tuition payment contract, occur.

(2) Except as provided in section 7(2)(b) and (3)(b), an advance tuition payment contract shall provide for a refund pursuant to this section to a person to whom the refund is payable under the contract upon termination of the contract. If the qualified beneficiary has a high school diploma or has reached the age of majority, and attends an institution of higher education, the amount of a refund, except as provided in subsection (4), shall be the lesser of the average tuition cost of all state institutions of higher education on the date of termination of the contract, or the face amount of the payment or payments and any accrued investment income attributable to the payment or payments, if he or she is covered by alternative 1, as described in section 7(5), or the lowest tuition cost of all state institutions of higher education on the date of termination of the contract if he or she is covered by alternative 2 or does not attend an institution of higher education. The amount of a refund shall be reduced by an appropriate percentage if the purchaser entered into an advance tuition payment contract that provided for a fixed number of credit hours less than the total number of credit hours required by a state institution of higher education for the awarding of a baccalaureate degree, by the amount transferred to a community or junior college on behalf of a qualified beneficiary when the contract is terminated as provided in section 6(4), and by the amount transferred to a state institution of higher education on behalf of a qualified beneficiary. Termination of a contract and the right to receive a refund shall not be authorized under the contract if the qualified beneficiary has completed more than 1/2 of the credit hours required by the state institution of higher education for the awarding of a baccalaureate degree. However, this provision shall not affect the termination and refund rights of a graduate of a community or junior college. Pursuant to this subsection and except as provided by subsection (3), the trust shall make refund payments in equal installments over 4 years and not later than August 15 of the year due.

(3) An advance tuition payment contract shall authorize a person, who is entitled under the advance tuition payment contract to terminate the contract, to direct payment of the refund to an independent degree-granting college or university located in this state or to a community or junior college located in this state. If directed to make payments pursuant to this subsection, the trust shall transfer to the designated institution an amount equal to the tuition due for the qualified beneficiary, but the trust shall not transfer a cumulative amount greater than the refund to which the person is entitled. If the refund exceeds the total amount of transfers directed to the designated institution, the excess shall be returned to the person to whom the refund is otherwise payable.

(4) Notwithstanding any other section of this act, the amount of a refund paid upon termination of the advance tuition payment contract by a person who directs the trust pursuant to subsection (3) to transfer the refund to an independent degree-granting college or university located in this state shall not be less than the prevailing weighted average tuition cost of state institutions of higher education for the number of credit hours covered by the contract on the date of termination. In calculating the amount of a refund for an advance payment contract containing the restrictions provided by section 7(5), the prevailing weighted average tuition cost shall be based upon only those state institutions of higher education at which the qualified beneficiary could have received sufficient credit hours for a baccalaureate degree.

Sec. 9. (1) There is created under the jurisdiction and control of the board an advance tuition payment fund. Payments received by the trust from purchasers on behalf of qualified beneficiaries or from any other source, public or private, shall be placed in the fund. The fund may be divided into separate accounts.

(2) Assets of the trust shall not be considered state money, common cash of the state, revenue for the purposes of sections 26 to 34 of article IX of the state constitution of 1963, nor state money for the purposes of Act No. 259 of the Public Acts of 1982, being sections 12.61 to 12.64 of the Michigan Compiled Laws.

(3) Unless otherwise provided by resolution of the board, assets of the trust shall be expended in the following order of priority:

(a) To make payments to state institutions of higher education on behalf of qualified beneficiaries.

(b) To make refunds upon termination of an advance tuition payment contract.

(c) To pay the costs of administration and organization of the trust and the fund.

(4) Assets of the trust may be invested in any instrument, obligation, security, or property considered appropriate by the trust and may be pooled for investment purposes with investments of the state, including, but not limited to, state pension funds, on such terms and conditions as are agreeable to the trust.

Sec. 10. (1) The board shall consist of the state treasurer, and 8 other members with knowledge, skill, and experience in the academic, business, or financial field, who shall be appointed by the governor, by and with the advice and consent of the senate. Not more than 2 of the 8 appointed members of the board shall be, during their term of office on the board, either officials, appointees, or employees of this state. Of the 6 remaining members appointed by the governor, 1 shall be appointed from 1 or more nominees of the speaker of the house of representatives, 1 shall be appointed from 1 or more nominees of the majority leader of the senate, 1 shall be a president of a state institution of higher education who shall be appointed from nominees of the president's

council of state colleges and universities, 1 shall be a president of a community or junior college who shall be appointed from nominees of the Michigan community college association, and 1 shall represent the interests of independent degree-granting colleges and universities located in this state. Six of the 8 appointed members shall serve for fixed terms. Of the 6 such members first appointed, 2 shall be appointed for a term that expires December 31, 1987, 2 shall be appointed for a term that expires December 31, 1988, and 2 shall be appointed for a term that expires December 31, 1989. Upon completion of each fixed term, a member shall be appointed for a term of 3 years. A member shall serve until a successor is appointed, and a vacancy shall be filled for the balance of the unexpired term in the same manner as the original appointment. The chief executive officer or director of any state department, who is a designated member of or an appointee to the board, may appoint a deputy to serve as a voting member of the board in the absence of the chief executive officer or director. The governor shall designate 1 member of the board to serve as its chairperson. The governor shall appoint 2 members of the board to serve at the pleasure of the governor, 1 of whom shall be designated by the governor as the president and chief executive officer of the trust and 1 of whom shall be designated by the governor as the vice-president of the trust.

(2) Members of the board, other than the president and vice-president if they are not otherwise employees of the state, shall serve without compensation, but shall receive reasonable reimbursement for actual and necessary expenses.

(3) The board may delegate to its president, vice-president, or others such functions and authority as the board considers necessary or appropriate. These functions may include, but are not limited to, the oversight and supervision of employees of the trust.

(4) A majority of the members of the board serving shall constitute a quorum for the transaction of business at a meeting of the board, or the exercise of a power or function of the trust, notwithstanding the existence of 1 or more vacancies. Voting upon action taken by the board shall be conducted by majority vote of the members present in person at a meeting of the board, and, if authorized by the bylaws of the board and when a quorum is present in person at the meeting, by use of amplified telephonic equipment. The board shall meet at the call of the chair and as may be provided in the bylaws of the trust. Meetings of the board may be held anywhere within the state.

(5) The business which the board may perform shall be conducted at a public meeting of the board held in compliance with the open meetings act, Act No. 267 of the Public Acts of 1976, being sections 15.261 to 15.275 of the Michigan Compiled Laws. Public notice of the time, date, and place of the meeting shall be given in the manner required by Act No. 267 of the Public Acts of 1976.

(6) A writing prepared, owned, used, in the possession of, or retained by the board in the performance of an official function shall be made available to the public in compliance with the freedom of information act, Act No. 442 of the Public Acts of 1976, being sections 15.231 to 15.246 of the Michigan Compiled Laws.

Sec. 11. In addition to the powers granted by other provisions of this act, the board shall have the powers necessary or convenient to carry out and effectuate the purposes, objectives, and provisions of this act, the purposes and objectives of the trust, and the powers delegated by other laws or executive orders, including, but not limited to, the power to:

(a) Invest any money of the trust, at the board's discretion, in any instruments, obligations, securities, or property determined proper by the board, and name and use depositories for its money.

(b) Pay money to state institutions of higher education from the trust.

(c) Impose reasonable residency requirements for qualified beneficiaries.

(d) Impose reasonable limits on the number of participants in the trust.

(e) Segregate contributions and payments to the trust into various accounts and funds.

(f) Contract for goods and services and engage personnel as is necessary and engage the services of private consultants, actuaries, managers, legal counsel, and auditors for rendering professional, management, and technical assistance and advice, payable out of any money of the trust.

(g) Solicit and accept gifts, grants, loans, and other aids from any person or the federal, state, or a local government or any agency of the federal, state, or a local government, or to participate in any other way in any federal, state, or local government program.

(h) Charge, impose, and collect administrative fees and charges in connection with any transaction and provide for reasonable penalties, including default, for delinquent payment of fees or charges or for fraud.

(i) Procure insurance against any loss in connection with the trust's property, assets, or activities.

(j) Sue and be sued; to have a seal and alter the same at pleasure; to have perpetual succession; to make, execute, and deliver contracts, conveyances, and other instruments necessary or convenient to the exercise of its powers; and to make and amend bylaws.

(k) Enter into contracts on behalf of the state.

(*l*) Administer the funds of the trust.

(m) Indemnify or procure insurance indemnifying any member of the board from personal loss or accountability from liability resulting from a member's action or inaction as a member of the board, including, but not limited to, liability asserted by a person on any bonds or notes of the authority.

(n) Impose reasonable time limits on use of the tuition benefits provided by the trust, if the limits are made a part of the contract.

(o) Define the terms and conditions under which money may be withdrawn from the trust, including, but not limited to, reasonable charges and fees for any such withdrawal, if the terms and conditions are made a part of the contract.

(p) Provide for receiving contributions in lump sums or periodic sums.

(q) Establish policies, procedures, and eligibility criteria to implement this act.

(r) Enter into arrangements with Michigan institutions of higher education for the trust to offer on behalf of the institution advance tuition payment contracts under which the Michigan institution of higher education will be contractually obligated to provide a beneficiary under the contract with credit hours of higher education in addition to those required for a baccalaureate degree.

Sec. 12. The board shall annually prepare or cause to be prepared an accounting of the trust and shall transmit a copy of the accounting to the governor, the majority leader of the senate, the speaker of the house of representatives, and the respective minority leaders of the senate and house of representatives. The board shall also make available the accounting of the trust to the purchasers of the trust. The accounts of the board shall be subject to annual audits by the state auditor general or a certified public accountant appointed by the auditor general.

Sec. 13. (1) The trust shall be administered in a manner reasonably designed to be actuarially sound such that the assets of the trust will be sufficient to defray the obligations of the trust.

(2) In the accounting of the trust made pursuant to section 12, the trust board shall annually evaluate and cause to be evaluated by a nationally recognized actuary the actuarial soundness of the trust and determine the additional assets needed, if any, to defray the obligations of the trust. If there are not funds sufficient to ensure the actuarial soundness of the trust as determined by the nationally recognized actuary, the trust shall adjust payments of subsequent purchasers to ensure its actuarial soundness. If there are insufficient numbers of new purchasers to ensure the actuarial soundness of a plan of the trust, the available assets of the trust attributable to the plan shall be immediately prorated among the then existing contracts, and these shares shall be applied, at the option of the person to whom the refund is payable or would be payable under the contract upon termination of the contract, either towards the purposes of the contract for a qualified beneficiary or disbursed to the person to whom the refund is payable or would be payable under the contract upon termination of the contract.

(3) An advance tuition payment contract shall not be entered by the trust until the internal revenue service has issued a favorable ruling or opinion that the purchaser of the advance tuition payment contract will not be considered actually or constructively to be in receipt of income. If an unfavorable ruling or opinion with regard to this issue is rendered by the internal revenue service, the board shall present a report to the legislature outlining recommendations for the modification and continuance of the program, including a recommendation of whether the trust may offer contracts on behalf of itself to provide for the advance purchase of incremental portions of the number of credit hours necessary for a baccalaureate degree.

(4) Before entering into advance tuition payment contracts with purchasers, the state shall solicit answers to appropriate ruling requests from the securities and exchange commission regarding the application of federal security laws to the trust. No contracts shall be entered without the authority making known the status of the request.

Sec. 14. State institutions of higher education, purchasers, and qualified beneficiaries may enforce this act and any contract entered into pursuant to this act in the circuit court for Ingham county.

Sec. 15. The property of the trust and its income and operation shall be exempt from all taxation by this state or any of its political subdivisions.

Sec. 16. The trust, in its discretion, may contract with others, public or private, for the provision of all or a portion of the services necessary for the management and operation of the trust. The trust shall also endeavor to work with private sector investment managers, state institutions of higher education, and independent degree-granting colleges and universities in this state to study the feasibility of instituting programs between these

parties that insure full tuition payment upon purchase of a prepayment plan. The trust shall evaluate the feasibility and actuarial soundness of a prepayment plan exclusively for community and junior colleges. The board shall submit a report to the legislature before December 31, 1988 regarding its success at instituting programs between private sector investment managers, state institutions of higher education, and independent degree-granting colleges and universities of the state that insure full tuition prepayment plans.

Sec. 17. The assets of the trust shall be preserved, invested, and expended solely pursuant to and for the purposes set forth in this act and shall not be loaned or otherwise transferred or used by the state for any purpose other than the purposes of this act. This section shall not be construed to prohibit the trust from investing in, by purchase or otherwise, bonds, notes, or other obligations of the state, an agency of the state, or an instrumentality of the state.

Sec. 18. Nothing in this act or in an advance tuition payment contract entered into pursuant to this act shall be construed as a promise or guarantee by the trust or the state that a person will be admitted to a state institution of higher education or to a particular state institution of higher education, will be allowed to continue to attend a state institution of higher education after having been admitted, or will be graduated from a state institution of higher education.

Sec. 19. An advance tuition payment contract shall be exempt from the uniform securities act, Act No. 265 of the Public Acts of 1964, being sections 451.501 to 451.818 of the Michigan Compiled Laws. An advance tuition payment contract may not be sold or otherwise transferred by the purchaser or qualified beneficiary without the prior approval of the trust.

Sec. 20. Pursuant to section 30 of the income tax act of 1967, Act No. 281 of the Public Acts of 1967, being section 206.30 of the Michigan Compiled Laws, the purchaser may deduct from taxable income the following payments made by the purchaser in the tax year:

(a) The amount of payment made under an advance tuition payment contract.

(b) The amount of payment made under a contract with a private sector investment manager that meets all of the following criteria:

(*i*) The contract is certified and approved by the board to provide equivalent benefits and rights to purchasers and beneficiaries as an advance tuition payment contract.

(*ii*) The contract applies only for a state institution of higher education or a community or junior college.

(*iii*) The contract provides for enrollment by the contract's qualified beneficiary in not less than 4 years after the date on which the contract is entered into.

(*iv*) The contract is entered into either:

(A) After the purchaser has had his or her offer to enter into an advance tuition payment contract rejected by the board, if the board determines that the trust cannot accept an unlimited number of enrollees upon an actuarially sound basis.

(B) After the board determines that the trust can accept an unlimited number of enrollees upon an actuarially sound basis.

Sec. 21. This act shall be construed liberally to effectuate the legislative intent, the purposes of the act, and as complete and independent authority for the performance of each and every act and thing authorized in the act, and all powers granted in the act shall be broadly interpreted to effectuate such intent and purposes and not as to limitation of powers.

Sec. 22. If any section, subsection, paragraph, clause, or provision of this act shall be adjudged unconstitutional or ineffective, no other section, subsection, paragraph, clause, or provision of this act shall on account thereof be considered invalid or ineffective, and the applicability or invalidity of any section, subsection, paragraph, clause, or provision of this act in any 1 or more instances or under any 1 or more circumstances shall not be taken to affect or prejudice its applicability or validity in any other instance or under any other circumstance.

Sec. 23. The trust shall not enter into an advance tuition payment contract with a purchaser until Senate Bill No. 59 of the 83rd Legislature is enacted into law.

Sec. 24. This act is repealed effective January 1, 1989 if the trust has not entered into an advance tuition payment contract with a purchaser before that date.

APPENDIX 2

SOME SAVING INCENTIVE PROPOSALS

An often discussed alternative to a tuition futures plan is simply a tuition savings plan that would not necessarily guarantee future tuition. The incentives found among the proposals described here include tax exemption and deduction, permission to withdraw funds for uses other than education, and an option to switch from a savings plan to a guarantee plan.

State Proposals

Pennsylvania — Tuition Account Program
Senate Bill No. 333, Introduced 1987

Pennsylvania's proposed Tuition Account Program (TAP) is a two-tiered approach to financing higher education: Although initially only a state tax-exempt savings plan, it is intended to evolve into a guarantee plan for public institutions. Participants would determine the amount of money that they would invest into TAP. When the investment reached a sufficient level, it could be shifted into the guarantee plan. But once in the guarantee plan, investments might still be added to the tuition account plan in order to cover costs at independent institutions. Funds could be transferred to any beneficiary and could be used by adults for their own education. (1) While the plan is intended for state residents, no stipulation would prevent portability of funds to an out-of-state institution.

New York — New York State Regents College Savings Fund
Proposed 1987

Recently proposed by the Regents, the New York State Regents College Savings Fund would promote saving by New York State residents of all income levels. The plan would offer state tax deductibility and state matching grants,

and it would accommodate employer contributions. The proposal is intended to finance education at New York State schools. Transferability of benefits would be limited to family members, and (similar to IRA provisions) withdrawal of funds for purposes other than education would be subject to taxation and penalties.

Illinois — College Savings Bonds
Senate Bills 2 and 875 (Amendment) and House Bill 180
Introduced 1987

These bills would authorize the State to sell $300 million worth of general obligation bonds intended specifically for higher education expenses. The bonds would be state tax-exempt zero-coupon bonds, purchased at deep discount to increase in value as they mature. The first $25,000 of a bond investment could not be considered in determining a student's financial aid eligibility. (2) Financial incentives, such as supplemental payments upon bond maturity, would be provided to bondholders to encourage attendance at in-state institutions. The Board of Higher Education and the State Scholarship Commission would be responsible for developing a college cost information program to encourage families to save for college.

Missouri — Higher Education Funding Accounts
Senate Bill 48, Introduced 1986

Similar to New York's former PASS Plan, Missouri's plan would offer state tax benefits for deposits into college savings accounts for designated beneficiaries of up to 18 years of age. Contributions of up to $2,000 a year could be deposited in a vehicle chosen by the originator of the account, who would not have to be a relative of the beneficiary. (3) Transferability would be limited to family members, and funds would have to be used by the beneficiary's thirtieth birthday. If funds were withdrawn for purposes other than education, a 10-percent excise tax would be imposed. (4)

It is felt by some that this plan would not offer sufficient incentive for families to participate--investing in other vehicles, such as municipal bonds, would provide comparable investment earnings, but would not involve a 10-percent penalty. Also, the state income tax rate is a relatively low six

percent in Missouri, so the deduction of the investment would not offer much of a benefit. (5)

Georgia — Georgia Educational Reinvestment Act for Aid to Families with Dependent Children (GERA)
Senate Bill 232, Introduced 1987

This plan is unique in the way it addresses the needs of low-income families. Under GERA, families with dependent children who receive public assistance could direct 10 percent of their assistance to a trust fund for their children's future higher education expenses. The fund would be invested in high-interest vehicles; the State could annually add appropriations to the fund. The families' investments could also be used as death benefits.

Federal Proposals

H.R. 817 — Family Education Assistance Act of 1987
Introduced 1987

Several federal proposals (H.R. 817, H.R. 995, and H.R. 1167) for education savings accounts, similar to IRAs, would create federal tax benefits. H.R. 817 is representative: It would permit establishment of education savings accounts and allow contributions of up to $1,500 a year to be deductible; earnings would be exempt. Use of an account for purposes other than tuition, room and board would carry extra tax liability of 10 percent. An account could be used by only one beneficiary, and contributions would be deductible until the beneficiary reached the age of 19. The funds could be used until the beneficiary was 30 years old.

NOTES

Executive Summary

1. California Student Aid Commission, "Tuition Prepayment Plans: Issues and Options for California," February 1987, p. 4.

2. Anderson, Richard, "Tuition Prepurchase Plans: Why They're Needed and What's at Stake," Change: The Magazine of Higher Learning, March/April 1987, p. 39.

Chapter 1

1. Hartle, Terry and Arthur Hauptman, "Tuition Increases Since 1970: A Perspective," Higher Education and National Affairs, Newsletter of the American Council on Education, Special Insert, February 23, 1987.

2. Hartle and Hauptman.

3. Hartle and Hauptman.

4. It is noted that for those middle-income families that have a child in college, the cost of college as a percentage of family income is not much greater than it was a decade ago. This rebuttal appears not, however, to incorporate the fact that more such families now have two wage-earners.

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direct payment. The Florida plan offers a separate payment plan for on-campus housing expenses: The Dormitory Residence Plan covers a beneficiary's housing fees for up to ten full-time semesters. Coverage may be purchased in increments of two semesters. Calculation of the cost is similar to that for tuition--it would be based primarily on:

- the number of years expected to elapse between the signing of the contract and the use of the benefits; and
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No meal plan, laundry service or telephone service is included. If sufficient housing is not available for all beneficiaries, a beneficiary or purchaser can obtain a refund for the amount of that semester's housing costs. Community college residence halls are not eligible.

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